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No. 06-

IN THE

Supreme Court of the United States

MBNA AMERICA BANK, N.A.,
Petitioner,

v.

TAX COMMISSIONER OF THE STATE OF WEST VIRGINIA,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of Appeals of West Virginia

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

This Court held in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), and *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), that under the Commerce Clause of the U.S. Constitution, art. I, § 8, a state may not (without congressional authorization) impose a sales or use tax collection obligation on a corporation that lacks a physical presence within the taxing state. Notwithstanding that precedent, and expressly acknowledging that it was joining one side of a direct conflict among state courts, the West Virginia Supreme Court of Appeals upheld the imposition of income and franchise taxes on petitioner, which lacks any physical presence in the state.

The Question Presented is:

Whether the Commerce Clause of the U.S. Constitution, art. I, § 8, permits states to impose income and franchise taxes on an out-of-state company with no in-state physical presence, simply because that company has customers in the taxing state.

LIST OF PARTIES AND CORPORATE DISCLOSURE

The petitioner is MBNA America Bank, N.A. ("MBNA"), now known as FIA Card Services, N.A. Petitioner is an indirect, wholly-owned subsidiary of Bank of America Corporation, which is a publicly-held company. This case concerns a dispute over taxes imposed for tax years 1998 and 1999. During that period, MBNA was a wholly-owned subsidiary of MBNA Corporation.

Respondent is the Tax Commissioner of the State of West Virginia.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner respectfully prays that a writ of *certiorari* issue to review the judgment of the Supreme Court of Appeals of West Virginia in this case.

DECISIONS BELOW

The opinion of the Supreme Court of Appeals of West Virginia is reported at 640 S.E.2d 226 (W. Va. 2006) and is reprinted in the Appendix ("App.") hereto at 1a. The opinion of the Circuit Court of Kanawha County, West Virginia is unpublished and is reprinted at App. 39a. The opinion of the Chief Administrative Law Judge of the West Virginia Office of Tax Appeals is unpublished and is reprinted at App. 53a.

JURISDICTION

The decision and majority opinion of the West Virginia Supreme Court of Appeals was issued on November 21, 2006. A dissenting opinion was issued on January 2, 2007, and a concurring opinion was issued on January 8, 2007. Chief Justice Roberts extended the time in which to file this petition to March 21, 2007. This Court has jurisdiction pursuant to 28 U.S.C. § 1257(a) (2006).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Commerce Clause, U.S. Const. art. I, § 8, provides:

> The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.

The relevant portions of the West Virginia statutes at issue in this case are set forth at App. 70a.

INTRODUCTION

This petition presents the single most important constitutional issue in state taxation of the last four decades: whether the Commerce Clause permits states to impose income and franchise taxes on an out-of-state company with no in-state physical presence, simply because that company has

customers in the taxing state. The longstanding rule governing state taxation provides that states may impose taxes on an out-of-state company only if that company or its representative has a physical presence in the taxing state. This Court expressly endorsed that rule in *National Bellas Hess, Inc. v. Dep't of Revenue of Illinois*, 386 U.S. 753 (1967), and affirmed its continuing viability twenty-five years later in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). And although both *Bellas Hess* and *Quill* involved the collection of sales and use taxes, rather than the direct imposition of income and franchise taxes, this Court expressly recognized in *Quill* that it had never upheld *any* kind of state tax on an out-of-state company unless that company had a physical presence in the taxing state.

The physical presence rule provides a clear, judicially manageable test that establishes meaningful limits on the ability of state taxing authorities to engage in extraterritorial taxation of out-of-state companies. The rule thereby fosters the fundamental purposes of the Commerce Clause, preventing undue burdens on the free flow of interstate commerce, limiting the risk that the same income will be taxed multiple times, and generally forestalling the "welter of complicated obligations" the Commerce Clause was designed to avoid. *Bellas Hess*, 386 U.S. at 760.[1]

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[1] As the Court explained in *Quill*, the Commerce Clause is based on "structural concerns about the effects of state regulation on the national economy." 504 U.S. at 312. Specifically, "the Framers intended the Commerce Clause as a cure for th[e] structural ills" caused by the "state taxes and duties" that "hindered and suppressed interstate commerce" under the Articles of Confederation. *Id.*; *see also* The Federalist No. 7, at 62-63 (C. Rossiter ed., 1961) (allowing each State to "pursue a system of commercial policy peculiar to itself" would "occasion distinctions, preferences, and exclusions, which would beget discontent"); The Federalist No. 11, at 89 ("An unrestrained intercourse between the States themselves will advance the trade of each, by an interchange of their respective productions, not only for the supply of reciprocal wants at home, but for exportation to foreign markets. The veins of commerce in every part

Nonetheless, in the wake of *Quill*, a split in state court authority developed concerning the applicability of the physical presence rule to taxes other than sales and use taxes. Even before *Quill* was decided, some state tax commissioners began assessing corporate income and franchise taxes on out-of-state businesses that had no in-state employees, representatives, or property. Some state courts—notably the Tennessee courts in *J.C. Penney Nat'l Bank v. Johnson*, 19 S.W.3d 831 (Tenn. Ct. App. 2000), *aff'd*, No. M1998-00497-SC-R11-CV (Tenn. May 8, 2000), *cert. denied*, 531 U.S. 927 (2000)—appropriately invalidated these efforts, concluding that *Quill*'s re-affirmation of the physical presence rule in the sales and use tax context did not imply *rejection* of that rule in other contexts.

But other state courts upheld these aggressive impositions of extraterritorial income and franchise tax. Seizing on dicta in *Quill*, these courts held that the physical presence rule does not apply in the income and franchise tax context. In so doing, these courts misconstrued *Quill*, drew strained distinctions between sales and income taxation that have no relevance to Commerce Clause analysis, and cast aside longstanding practice in state taxation. The first state supreme court to uphold extraterritorial income taxation absent in-state physical presence—the South Carolina Supreme Court in *Geoffrey, Inc. v. South Carolina Tax Commission*, 437

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will be replenished and will acquire additional motion and vigor from a free circulation of the commodities of every part.").

For this reason, as the Court recognized in *Quill*, the Commerce Clause's limits on state taxation authority are more restrictive than the "minimum contacts" needed to support personal jurisdiction under the Due Process Clause. *Quill*, 504 U.S. at 312-13 (noting that the clauses are "animated by different constitutional concerns and policies"). Whereas due process analysis is concerned with the effects of a state's exercise of power over an individual (and thus focuses on the individual's contacts with the state), the Commerce Clause is concerned primarily with the effects of a state's exercise of power *on other states* (and thus focuses on obstruction of interstate commercial activity). *Id.*

S.E.2d 13 (S.C. 1993)—did so in connection with an out-of-state holding company that owned trademarks and trade names that it licensed for in-state use by its affiliate in South Carolina. The court held that the licensing of intellectual property in that situation was a sufficient basis on which to tax an out-of-state corporation.

Following *Geoffrey*, most state courts of appeal that upheld imposition of income and franchise taxes absent physical presence similarly did so in cases involving companies that licensed intellectual property for in-state use by affiliated entities. But the New Jersey Supreme Court recently took another step, affirming a tax court decision that expressly stated that licensing intellectual property for use in-state would be sufficient to support income and franchise taxation under the Commerce Clause even if the property was licensed to an *un*affiliated in-state company. *See Lanco, Inc. v. Dir., Div. of Taxation*, 879 A.2d 1234, 1236 (N.J. Super. Ct. App. Div. 2005), *aff'd*, 908 A.2d 176 (N.J. 2006).

A scant month and a half later, the West Virginia Supreme Court of Appeals issued its decision in this case, obliterating once and for all any notion that departure from the physical presence rule can be limited to situations involving intangible property licenses or affiliated entities. Petitioner in this case has substantial physical facilities and thousands of employees in, and has paid millions of dollars in taxes to, the State of Delaware. But it has no physical presence whatsoever in the State of West Virginia. Nevertheless, the West Virginia Supreme Court—expressly acknowledging the conflict with the Tennessee courts—held that petitioner is subject to taxation in West Virginia solely because it has *customers* in West Virginia. Thus, under the West Virginia Court's interpretation of *Quill*, essentially any company that receives revenue from West Virginia customers could be subject to income and franchise tax.

The decision below thereby eliminates virtually *any* limit on the states' authority to impose extraterritorial taxation. It thus conflicts frontally with *Bellas Hess* and *Quill*, and

threatens to subject interstate commerce to severe burdens, directly contrary to the purposes of the Commerce Clause. The decision below also brings full circle the conflict that developed in the wake of *Quill*. The *J.C. Penney* case in Tennessee followed the physical presence rule and held that an out-of-state credit-card company cannot be subject to income and franchise taxes merely because it has customers in the taxing state. Other courts rejected the physical presence rule and held that out-of-state intangible holding companies could be taxed on the basis of in-state intellectual property licenses. The West Virginia Supreme Court of Appeals has now departed even more radically from *Quill*, holding that the physical presence rule does not apply to income and franchise taxes *at all*. And in so holding the court reached a conclusion directly contrary to the Tennessee courts' decision in *J.C. Penney* on indistinguishable facts: an out-of-state credit-card company *can* be subject to income and franchise taxes merely because it has customers in the taxing state.

This Court should intervene to resolve this conflict, and to re-affirm meaningful limits on state taxation authority under the Commerce Clause. The scope of the states' extraterritorial taxing authority is an issue of fundamental economic importance to virtually every entity involved in interstate or international commerce, including the rapidly-growing number of small companies involved in commerce over the Internet. Resolution of the issue by this Court is essential to ensuring that the free flow of this commerce is not disrupted.

STATEMENT OF THE CASE

A. Factual Background

Petitioner MBNA is a chartered national bank.[2] Its principal business activity is issuing and servicing major credit cards for customers throughout the U.S. MBNA is incorporated in Delaware. It has its principal place of business in

[2] After the litigation in this case began, MBNA Corporation was acquired by Bank of America Corporation.

Delaware and a robust physical presence there, including more than ten thousand employees. In 1998 and 1999, MBNA paid millions of dollars in bank franchise (income) taxes to Delaware.

MBNA has no physical presence—no office, no employees, no place of business, no real property, and no tangible personal property—in West Virginia. *See* App. 4a (noting for purposes of decision below that "it was agreed that MBNA does not have a physical presence in West Virginia"). Nonetheless, in tax years 1998 and 1999, West Virginia imposed two kinds of taxes, business franchise and corporate net income taxes, on MBNA based on its income attributable to customers with West Virginia addresses.[3] MBNA paid a franchise tax of $32,010 and a corporate income tax of $168,034 in 1998, and a franchise tax of $42,339 and an income tax of $220,897 in 1999.

B. Proceedings Below

1. In September 2002, MBNA filed claims for refunds of its 1998 and 1999 franchise and corporate income taxes, arguing that the West Virginia Tax Commissioner lacked the constitutional authority to impose those taxes on MBNA. The Tax Commissioner denied the refunds, finding that MBNA regularly engaged in business in West Virginia under the state's statutory tests. App. 3a.

2. MBNA filed a petition for refund with the West Virginia Office of Tax Appeals ("OTA"). The OTA's Chief Administrative Law Judge ("ALJ") ruled in favor of MBNA. The ALJ observed that under this Court's decision in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), a state tax on interstate commerce is valid only if it is "applied to an activity with a substantial nexus with the taxing State."

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[3] Both the business franchise and corporate net income taxes are imposed on out-of-state financial organizations that obtain or solicit business with twenty or more persons in the state, or whose gross receipts attributable to sources in West Virginia equal or exceed $100,000. *See* W. Va. Code §§ 11-23-5a(d), 11-24-7b(d).

App. 60a (quoting 430 U.S. at 279) (alterations omitted). The West Virginia franchise and business income tax statutes, the ALJ noted, employ an "economic-exploitation-of-the-market standard for nexus, rather than a 'physical presence' nexus standard." App. 62a. But, the ALJ observed, this Court made clear in *Quill* that a "'substantial' nexus requires a finding of physical presence in the taxing state, not merely an economic exploitation of the market." App. 63a.

The ALJ concluded that this physical presence rule applies to income and franchise taxes. While *Quill* noted in dictum that this Court had not explicitly articulated a physical presence rule outside the sales and use tax context, the ALJ observed, *Quill* also made clear that the Court had upheld other kinds of state taxes *only* in situations in which the taxpayers had a physical presence in the taxing state. App. 62a. Moreover, the ALJ continued, the Court in *Complete Auto* did not distinguish between different types of state taxes when it set forth the "substantial nexus" requirement under the Commerce Clause. *Id.* If anything, the ALJ added, the "substantial nexus" requirement "should apply with even more force to direct taxes" like income and franchise taxes, because "direct taxes against a taxpayer . . . are more *financially* onerous than mere collection duties." App. 62a n.2. The ALJ thus held that the West Virginia franchise and income taxes, as applied to MBNA, violated the Commerce Clause. App. 68a.

3. The Tax Commissioner appealed, and the Circuit Court of Kanawha County reversed. The court noted that MBNA's gross receipts attributable to West Virginia sources for 1998 and 1999 met the statutory thresholds for nexus under the West Virginia statutes. App. 48a. The court also observed that no West Virginia case law or statute required physical presence in order to establish a taxation nexus, and asserted that the bright-line physical presence rule enunciated in *Bellas Hess* and *Quill* had "no application" because MBNA's case did not concern "sales and use taxes." *Id.* The court then concluded that MBNA had a substantial

nexus with West Virginia based on its revenue from West Virginia citizens, the fact that MBNA extends credit to West Virginia residents, and the fact that West Virginia provided MBNA with "banking[] and consumer credit laws as well as access to its courts." App. 49a.

4. MBNA appealed to the West Virginia Supreme Court of Appeals, which affirmed over a vigorous dissent. The single issue in the case, the court recognized, was whether application of the franchise and corporate income taxes to MBNA, "a business with no physical presence in th[e] state, violates the Commerce Clause of the United States Constitution." App. 5a. After reviewing *Bellas Hess* and *Quill*, the court concluded that the physical presence rule affirmed in *Quill* "applies only to use and sales taxes and not to business franchise and corporation net income taxes." App. 12a. Citing this Court's statement in *Quill* that contemporary Commerce Clause jurisprudence might not dictate the same result as in *Bellas Hess*, the West Virginia court concluded that *Quill*'s reaffirmation of the *Bellas Hess* physical presence rule was "grounded primarily on *stare decisis*." *Id.* The court also suggested that this Court had "expressly limited *Quill*'s scope to sales and use taxes," quoting dicta in which this Court observed that it had not expressly articulated a physical presence requirement in relation to other types of taxes. App. 13a-14a. The West Virginia court further noted that the decisions in *Bellas Hess* and *Quill* relied in part on the burdens sales and use tax would place on interstate commerce, and asserted that "the franchise and income taxes at issue in this case do not appear to cause the same degree of compliance burdens." App. 16a. Finally, the court asserted that the physical presence rule, "articulated in 1967, makes little sense in today's world," because the "growth of electronic commerce now makes it possible for an entity to have a significant economic presence in a state absent any physical presence there." App. 17a.

Based on this analysis, the court concluded that a "significant economic presence test" was a "better indicator of

whether substantial nexus exists for Commerce Clause purposes" than the physical presence rule endorsed by this Court. App. 18a. Such a test, the court indicated, would "incorporat[e] due process purposeful direction towards a state while examining the degree to which a company has exploited a local market," but would also involve "an examination of both the quality and quantity of the company's economic presence," including attention to "the frequency, quantity and systematic nature of a taxpayer's economic contacts with a state." *Id.* (quotation omitted). The court acknowledged that its "substantial economic presence standard" was "by nature more elastic than the bright-line physical presence test" mandated by *Quill*, but asserted that its standard was not equivalent to the Due Process minimum contacts standard rejected for Commerce Clause purposes in *Quill*. App. 20a.

The Court further acknowledged that its decision conflicted squarely with the decision in *J.C. Penney*, but stated simply that it "reject[ed] the reasoning in *J.C. Penney* and decline[d] to apply it to the instant case." App. 21a. The court then concluded, based on MBNA's solicitation of customers in West Virginia and the amount of its gross receipts, that MBNA's contacts with West Virginia constituted a "substantial nexus" that would support income and franchise taxation. *Id.* Finally, the court emphasized the ostensible significance of "ever-evolving practices of the marketplace" in devising new Commerce Clause analyses:

> James Madison, Benjamin Franklin, and the other Framers at the Constitutional Convention who adopted the Commerce Clause lived in a world that is impossible for people living today to imagine. The Framers' concept of commerce consisted of goods transported in horse-drawn, wooden-wheeled wagons or ships with sails. They lived in a world with no electricity, no indoor plumbing, no automobiles, no paved roads, no airplanes, no telephones, no televisions, no computers, no plastic credit cards, no re-

> corded music, and no iPods. Likewise, it would have been impossible for the Framers to imagine our world. When they fashioned the Commerce Clause, they could not possibly have foreseen the complex and varied ways that commerce is conducted today, especially via the internet and electronic commerce. It would be nonsense to suggest that they could foresee or fathom a time in which a person's telephone call to his or her local credit card company would be routinely answered by a person in Bombay, India, or that a consumer could purchase virtually any product on a computer with the click of a mouse without leaving home. This recognition of the staggering evolution in commerce from the Framers' time up through today suggests to this Court that in applying the Commerce Clause we must eschew rigid and mechanical legal formulas in favor of a fresh application of Commerce Clause principles tempered with healthy doses of fairness and common sense. This is what we have attempted to do herein.

App. 22a.

Justice Benjamin dissented. He "agree[d]" with the majority that "the 'substantial nexus' prong of [the *Complete Auto*] test [was] ripe for clarification by the United States Supreme Court," App. 30a, but disagreed with the majority's "strained and inaccurate reading" of *Quill*, App. 27a-28a, concluding that, in fact, this Court's precedent made clear that the taxes levied on MBNA were unconstitutional, App. 30a. Specifically, he noted that "the credit card accounts which give rise to MBNA's income are located outside West Virginia," and that the majority had "fail[ed] to show how the[se] out-of-state credit account[s]" met the "substantial nexus requirements of *Complete Auto* and *Quill*." App. 31a-32a.

The majority, Justice Benjamin explained, distinguished *Quill* principally by drawing an invalid distinction between sales and use taxes on the one hand, and income and fran-

chise taxes on the other. This Court, he observed, "has not generally treated the question of state authority to tax interstate commerce as turning on the specific type of tax involved," but rather has focused on "the effect of the tax which the taxing state seeks to levy on interstate commerce." App. 33a. In fact, he continued, "there is no immediately clear doctrinal foundation which can be observed for distinguishing sales and use tax collection on sales between states from income taxes sought to be collected from out-of-state companies for income realized from out-of-state intangible accounts." *Id.* Indeed, collection of sales and use taxes, the dissent observed, is no more complex than the determination of income tax liability for multistate corporations. App. 35a. Moreover, the dissent added, this Court has never held in any state tax case that the nexus requirement can be satisfied absent physical presence, and "[t]he principles of *stare decisis* are no less relevant to state taxes in general, than they are to sales and use taxes particularly." App. 34a. Finally, the dissent noted that the majority's argument for an economic presence standard based on modern economic circumstances was "remarkably like the arguments set forth" in the dissent in *Bellas Hess* and the North Dakota Supreme Court in *Quill*—both of which had been decisively rejected by this Court. App. 37a.

REASONS FOR GRANTING THE WRIT

I. THE STATES ARE IN CONFLICT OVER THE APPLICABILITY OF *QUILL*'S PHYSICAL PRESENCE RULE TO INCOME AND FRANCHISE TAXES

A. This Court's Cases Have Established A Bright-Line Physical Presence Rule For State Taxation

Physical presence has long been the touchstone of state authority to tax out-of-state corporations. *See, e.g.*, J. Hellerstein & W. Hellerstein, *State and Local Taxation* 386 (8th ed. 2005) ("courts traditionally have regarded a corporation's physical presence in a state as necessary to establish jurisdic-

tion to subject that corporation to income taxation"). This Court expressly endorsed this physical presence rule in *Bellas Hess*, 386 U.S. at 753, which held that Illinois could not constitutionally impose use-tax collection obligations on a Missouri mail-order company that had customers in Illinois, but whose only contacts with Illinois were "via the United States mail or common carrier." *Id.* at 754. Canvassing Supreme Court precedent dating back to 1939, the Court observed that it had drawn a "sharp distinction" between "sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier." *Id.* at 758. "[T]his basic distinction," the Court continued, "until now has been generally recognized by the state taxing authorities," and "is a valid one." *Id.* The Court therefore "decline[d] to obliterate it." *Id.*; *see also infra* at 23-30 (discussing reasons for rule).

A decade later, in *Complete Auto*, 430 U.S. at 274, the Court distilled the standards for state taxation under the Commerce Clause into a four-part test, holding that to satisfy the Constitution, a tax (1) must be "applied to an activity with a substantial nexus with the taxing State," (2) must be "fairly apportioned," (3) must "not discriminate against interstate commerce," and (4) must be "fairly related to the services provided by the State." *Id.* at 279. Some states treated *Complete Auto* as an invitation to revisit *Bellas Hess* and—despite this Court never having questioned that case—began holding that the physical presence rule had been rendered "obsole[te]" by "the tremendous social, economic, commercial, and legal innovations" that had taken place since it was decided. *State v. Quill Corp.*, 470 N.W.2d 203, 208 (N.D. 1991).

In *Quill*, 504 U.S. at 298, this Court rebuffed these efforts to overturn *Bellas Hess*, rejecting the "changed modern marketplace" argument and reaffirming the continuing viability of the physical presence rule. The Court recognized that the bright-line rule articulated in *Bellas Hess* "furthers

the ends of the dormant Commerce Clause," encouraging settled expectations and fostering investment in interstate commerce. *Id.* at 314-16. The Court also noted the substantial reliance interest that had developed in the physical presence rule, *id.* at 317, and the "undu[e] burden" on interstate commerce that widespread state taxation could impose, *id.* at 313 & n.6.

B. Some State Court Decisions Adhered To *Quill* And Rebuffed State Efforts To Override The Physical Presence Rule

Despite *Quill*'s re-affirmation of the physical presence rule, a split in state court authority quickly developed in the wake of *Quill* over whether that rule continued to apply beyond the sales and use tax context in which *Quill* was decided. Even as *Quill* was working its way through the courts, some states (seeking to expand their revenue from out-of-state sources) began imposing income and franchise taxes on out-of-state companies that had no in-state physical presence. *See, e.g., Geoffrey*, 437 S.E.2d at 15 (noting that South Carolina imposed income tax and business license fees for tax years 1986 and 1987).

Some state courts struck down these aggressive and unprecedented assertions of extraterritorial taxing authority, recognizing that they were fundamentally at odds with the Commerce Clause rationale underlying *Quill*. Within a year of this Court's decision in *Quill*, the Michigan court of appeals had applied *Quill*'s physical presence rule to nexus questions in two cases that involved not sales and use tax collection, but Michigan's unique "single business tax," a business activity tax that (like net income and franchise taxes in other states) was imposed on companies for the privilege of doing business in the state. *See Guardian Indus. Corp. v. Dep't. of Treas.*, 499 N.W.2d 349 (Mich. App. 1993), *leave to appeal denied*, 512 N.W.2d 846 (1994); *Gillette Co. v. Dep't. of Treas.*, 497 N.W.2d 595 (Mich. App. 1993), *leave to appeal denied*, 519 N.E.2d 156 (Mich. 1994), *cert. denied*, 513 U.S. 1103 (1995).

Subsequently, in *J.C. Penney*, 19 S.W.3d at 831, the Tennessee Court of Appeals held that the physical presence rule applies to income and franchise taxes. *J.C. Penney* involved an out-of-state credit card company with no physical presence in Tennessee that was nonetheless assessed franchise and excise (income) taxes based on income from Tennessee cardholders. The Tennessee Court of Appeals held that imposition of these taxes was unconstitutional, applying the physical presence rule articulated in *Quill*. Rejecting the tax commissioner's argument that *Bellas Hess* and *Quill* were limited to sales and use taxes, the court observed:

> While it is true that the *Bellas Hess* and *Quill* decisions focused on use taxes, we find no basis for concluding that the analysis should be different in the present case. In fact, the Commissioner is unable to provide any authority as to why the analysis should be different for franchise and excise taxes.

Id. at 839. The tax commissioner appealed this decision to the Tennessee Supreme Court, which issued an order denying the application to appeal and permitting the decision to be published. *See J.C. Penney*, No. M1998-00497-SC-R11-CV (Tenn. May 8, 2000) (per curiam), *cert. denied*, 531 U.S. 927 (2000). Under Tennessee law, such an order establishes the supreme court's substantive agreement with the result below, and gives the opinion precedential effect. *See Pairamore v. Pairamore*, 547 S.W.2d 545, 548 (Tenn. 1977); *Meadows v. State*, 849 S.W.2d 748, 752 (Tenn. 1992).

The Court of Appeals of Texas has also agreed, holding that the bright-line physical presence requirement endorsed in *Quill* applies to franchise and income taxes. *Rylander v. Bandag Licensing Corp.*, 18 S.W.3d 296, 299-300 (Tex. App. 2000).[4]

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[4] While neither the Texas nor the Michigan appellate decisions has the functional status of a state supreme court opinion that *J.C. Penney* has, they are nevertheless binding precedent statewide in those jurisdic-

C. A Direct Conflict Has Arisen As State Court Decisions Have Begun Eliminating The Physical Presence Rule For Income And Franchise Taxes

State court adherence to *Quill* and the bright-line physical presence rule, however, has not been uniform. In contrast to the courts in Tennessee, Michigan, and Texas, courts in other states have held that the physical presence rule is limited only to sales and use taxes, and that the Commerce Clause permits direct taxation of out-of-state companies even absent physical presence.

The first decision to adopt this position was *Geoffrey*, 437 S.E.2d at 13. Like the *Guardian* and *Gillette* decisions in Michigan, *Geoffrey* was decided within a year of *Quill*, but with a diametrically opposite result. *Geoffrey* involved a Delaware corporation that had been established to take ownership of trademarks and trade names that it then licensed back for use to an affiliated company in South Carolina. *Id.* at 15. The Delaware company argued that it could not be taxed on its royalty income because it had no physical presence in South Carolina. *Id.* The South Carolina Supreme Court disagreed, finding that the physical presence rule articulated in *Quill* "had not been extended to other types of taxes," and holding that "by licensing intangibles for use in [South Carolina]" by its affiliates, the Delaware corporation had a "substantial nexus" with South Carolina. *Id.* at 18 & n.4.

Several other state appellate courts subsequently followed suit, concluding that *Quill*'s endorsement of the physical presence rule was limited to the sales and use tax context, and imposing franchise or income taxes on out-of-state companies that licensed intellectual property for in-state

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tions. *See, e.g., Tebo v. Havlik*, 343 N.W.2d 181, 185 (Mich. 1984); *Mesina v. State*, 904 S.W.2d 178, 181 (Tex. 1995). Further, the Michigan Department of Revenue has announced that it will adhere to the physical presence rule, cementing the rule in that state. *See J.W. Hobbs Corp. v. Dep't of Treas.*, 706 N.W. 2d 460, 463 (Mich. Ct. App. 2005).

use by affiliated companies. *See, e.g., A&F Trademark, Inc. v. Tolson*, 605 S.E.2d 187 (N.C. App. 2004), *certification denied*, 611 S.E.2d 168 (N.C.), *cert. denied*, 126 S.Ct. 353 (2005); *Kmart Props., Inc. v. Taxation & Revenue Dep't*, 131 P.3d 27 (N.M. Ct. App. 2001), *writ quashed*, 131 P.3d 22 (N.M. 2005).

More recently, in *Lanco*, 908 A.2d at 177, the New Jersey Supreme Court upheld imposition of a business income tax on an out-of-state company based on license income from use of that company's licensed intellectual property in New Jersey. The court recognized that a "split of authority" had developed since *Quill*, but concluded that "the better interpretation of *Quill* is the one adopted by those states that limit the Supreme Court's holding to sales and use taxes." *Id.* Dispelling any thought that prior cases in the *Geoffrey* line could be limited to intellectual property transactions among affiliated entities, the New Jersey courts specifically made clear that "common ownership" between licensor and licensee "is not material to the constitutional issue concerning" the application of the tax. *Lanco*, 879 A.2d at 1236 (quotation omitted).

Finally, in the decision below in this case, the Supreme Court of Appeals of West Virginia adopted a sweeping assertion of extraterritorial state taxation power, essentially concluding that the state could tax *any* company that has customers in West Virginia. The decision here brings the conflict in authority to full maturity. *Geoffrey* started the trend away from the physical presence rule in the context of intangible holding companies. The New Jersey Supreme Court in *Lanco* extended it by expressly rejecting the legal relevance of corporate affiliation. Now the West Virginia Supreme Court has held that a state may tax an out-of-state corporation where there is neither intangible property nor corporate affiliation, but mere sales to in-state customers. And it did so on facts indistinguishable from the facts of the *J.C. Penney* case—*i.e.*, an out-of-state credit-card company with no physical presence in the state—while reaching exactly the

opposite result. That conflict simply illustrates the broader significance of the decision below: by flatly eliminating the physical presence rule outside the context of sales and use taxes, it throws open the gates to direct state taxation of any and all out-of-state businesses in any and all circumstances, so long as those businesses have in-state customers.

D. The Legal Controversy Is Expanding As States Take Legislative And Administrative Steps To Eliminate The Physical Presence Rule, Just As They Did Following *Bellas Hess*

The reported judicial opinions are only the most visible reflection of the current disarray in the standards governing state taxation authority. Even beyond the jurisdictions discussed above, numerous states have enacted statutes or promulgated regulations that, to varying degrees, abandon the physical presence rule and implicitly adopt various alternative interpretations of the substantial nexus requirement—just as they did with respect to sales and use tax collection obligations in the wake of *Bellas Hess*. *See supra* at 12. In the banking and financial services industry, at least eight states have adopted alternative nexus standards by statute. *See* Ala. Code §§ 40-16-1 *et seq.*; Ala. Reg. 810-9-1-01 *et seq.*; Ind. Code §§ 6-5.5-1-1 *et seq.*; Iowa Code § 422.60 *et seq.*; Ky. Rev. Stat. Ann. §§ 136.500 *et seq.*; Mass. Gen. Laws c. 63, §§ 1 *et seq.*; Minn. Stat. § 290.015 (Subd. 2)(a)(2); Tenn. Code Ann. §§ 67-4-2105(e)(1),(2); W. Va. Code §§ 11-24-1 *et seq.* In addition, at least seven states have adopted alternative nexus standards for general corporations. *See* Ark. Reg. 1996-3 (Ark. Dep't of Fin. & Admin. (Aug. 9. 1996)); Fla. Admin. Code r. 12C-1.011; Iowa Admin. Code r. 701.52.1(422); Directive 96-2 (Mass. Dep't of Revenue July 3, 1996); Minn. Stat. § 290.015; Okla. Admin. Code § 710:50-17-3(a)(9); Wis. Admin. Code § 2.82(4)9. These statutory and regulatory schemes subject out-of-state companies who merely have customers within the state to taxation, even absent any physical presence.

Other states have not yet attempted to exert taxation authority absent physical presence, but they are being actively encouraged to do so. The Multistate Tax Commission ("MTC"), an organization of state governments, is urging states to adopt its model nexus statute, which provides that a substantial nexus is established if an out-of-state company has more than $500,000 of sales to customers in the taxing state.[5] In addition, legislation has been introduced in Oregon, Idaho, and New Hampshire, proposing that those states adopt economic nexus provisions. *See* S.B. 177, 74th Leg. (Or. 2007); H.B. 141, 59th Leg. (Idaho 2007) (passed House Feb. 16, 2007; passed Senate Mar. 2, 2007); H.B. 351, 2007 Sess. (N.H.). It is thus a virtual certainty that absent guidance from this Court, states will seek to expand their taxing power beyond their physical boundaries and into the domain of other states, in the face of this Court's precedents and to the increasing detriment of interstate commerce.

II. THE CONFLICT AMONG THE STATES HARMS INTERSTATE COMMERCE AND REQUIRES RESOLUTION BY THIS COURT

The conflict over the appropriate extent of states' extraterritorial taxation authority is highly significant and should be resolved by this Court. Perhaps most critically, uncertainty over state taxation authority disrupts and deters interstate commerce by hampering reliable strategic business planning. A business seeking to predict the tax liability arising from particular business activities cannot be sure what exactly will subject it to taxation in a given jurisdiction—a tangible physical presence, an intellectual property licensee or two, the presence of a few customers, a minimal amount of attributable revenue, or something else. Because the ex-

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[5] *See* MTC, Factor Presence Nexus Standard for Business Activity Taxes, available at http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/FactorPresenceNexusStandardBusinessActTaxes.pdf (visited Mar. 4, 2007).

tent of states' tax authority is still being litigated, even the *current* basis for liability in many states is uncertain.[6]

And absent clear guidance from this Court, there is no reliable way for businesses to predict how far jurisdictions will assert taxation authority in the *future*, and whether those assertions will be upheld in court. This renders long-term strategic decisions, including decisions about where to invest, difficult. The situation is particularly acute for small and medium-size companies that conduct business over the Internet, and are too small to risk developing customer bases in other states if there is some chance that doing so may subject them to the significant economic and compliance burdens of additional taxation.

The states themselves also suffer from uncertainty about the limits imposed by the Commerce Clause. On the one hand, those states that continue to apply the physical presence rule may be forgoing revenue. On the other hand, those states that are aggressively asserting extraterritorial taxing power may be inappropriately interfering with the revenue base and commercial conditions of other states. And all states lose when the national market is constrained by conflicting, self-interested state tax obligations, as this Court and the Constitution's Framers recognized. *See supra* note 1.

This issue's importance extends even to *foreign* commerce. The international tax treaties the United States has signed provide that the U.S. will not impose federal taxes on foreign corporations' business income unless they have a "permanent establishment" in the United States, normally

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[6] Indeed, even where states have clearly held that the physical presence rule applies only to sales and use taxes, there is often uncertainty about whether a given tax is properly denoted a sales or use tax, as opposed to an income or franchise tax. Taxes on "gross receipts," for example, could be described as taxes on *sales* within the state, or as taxes on *income* received outside the state. Such definitional uncertainties only underscore why the bright-line physical presence rule should apply uniformly to all taxes.

defined as a "fixed place of business through which the business of an enterprise is wholly or partly carried on." 1996 U.S. Model Income Tax Treaty, Art. 5. These treaties, however, generally do not prevent States and localities from taxing foreign corporations. *See Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 196-97 (1983). As a result, if the uncertainty in state authority is not resolved, states may begin to impose taxes directly on foreign corporations based simply on the fact that they have customers in the taxing state, effectively frustrating the limitations on tax liability the U.S. tax treaties contemplate. *Cf. Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 448-49 (1979) (noting that "a state tax on the instrumentalities of foreign commerce may impair federal uniformity in an area where federal uniformity is essential"). This in turn may invite foreign jurisdictions to impose retaliatory taxes, harming U.S. companies doing business abroad and undermining the treaties' fundamental purpose. *Cf. id.* at 450 (noting risk of foreign retaliation if "novel state tax" causes an "asymmetry in the international tax structure").

Finally, the current uncertainty over state extraterritorial taxing authority is itself generating enormous—and enormously wasteful—litigation costs. *Cf. Quill*, 504 U.S. at 315 (noting that a clear rule establishing the boundaries of state taxation authority would "reduc[e] litigation concerning those taxes"). States have an incentive to maximize their tax revenues, especially by imposing tax on out-of-state companies that are not members of the state's political society. Accordingly, state tax authorities will likely continue to assert aggressively the power to tax out-of-state companies, as they have in the past. Out-of-state companies, conversely, already pay large amounts of tax to the jurisdictions where they have employees and maintain tangible property, and will continue to resist these aggressive attempts at extraterritorial taxation. It is thus hardly surprising that the extent of state taxation authority has been vigorously litigated, and virtually certain that such litigation will continue if this

Court does not reaffirm the clear Commerce Clause limits on the states' power to engage in extraterritorial taxation.

This Court recognized in *Quill* that "firmly establish[ing] the boundaries of legitimate state authority to impose" taxes is essential, because "application of constitutional principles to specific state statutes leaves much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their" taxation power. *Quill*, 504 U.S. at 315 (quotation omitted). But while *Quill* explicitly reaffirmed the "precise guide" of the physical presence rule in the context of sales and use taxes, its dicta concerning "other types of taxes" gave willing states an opening to disrupt long-settled expectations built upon the traditional physical presence rule. As a result, "controversy and confusion" now dominate the state taxation landscape. This Court should resolve the controversy its *Quill* dicta has wrought by granting certiorari and reaffirming the applicability of the physical presence rule to all forms of state taxation.

III. THE DECISION BELOW IS INCORRECT AS A MATTER OF BOTH PRECEDENT AND POLICY

Long before *Bellas Hess* and *Quill* were decided, physical presence was already the generally-accepted rule limiting states' authority to impose any extraterritorial tax on out-of-state companies. *See supra* at 11-12. *Bellas Hess* and *Quill* confirmed the application of that rule to sales and use taxes. The question here is whether there is any basis in precedent or logic for treating income and franchise taxes differently from sales and use taxes for purposes of the Commerce Clause.

The answer is no. Neither Congress nor this Court has ever endorsed a rule other than physical presence for satisfaction of the Commerce Clause substantial nexus requirement. And contrary to the decision below, *Quill*'s analysis confirms that physical presence is an essential component of the Commerce Clause's nexus requirement for all types of state taxes. The physical presence rule also plays an impor-

tant role in reinforcing the federal system, and provides a well-established, judicially manageable default rule that sets meaningful limits on state taxation authority, thereby furthering the fundamental purposes of the Commerce Clause.

A. *Quill* Does Not Support Application Of Vague Economic Presence Measures For Taxes Other Than Sales And Use Taxes

Neither *Quill* nor this Court's other Commerce Clause precedents provide a basis for abandoning the physical presence rule outside the context of sales and use taxes, or for establishing a unique rule for sales and use taxes alone. It is true—as the West Virginia Supreme Court of Appeals below noted—that this Court stated in *Quill* that "we have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes." App. 13a-14a (quoting *Quill*, 504 U.S. at 314); *see also Quill*, 504 U.S. at 317. But that dicta does not, by its plain terms, purport to *abolish* the physical presence rule outside the sales and use tax context.

Indeed, *Quill* itself expressly recognized that this Court's prior cases upholding state taxes have all "involved taxpayers who had a physical presence in the taxing State." *Quill*, 504 U.S. at 314. These prior cases include numerous cases involving taxes other than sales and use taxes. *See id.* at 314 (citing *Tyler Pipe Indus., Inc. v. Washington State Dep't of Revenue*, 483 U.S. 232 (1987) (upholding a business and occupation tax)); *id.* at 311 (citing *Mobil Oil Corp. v. Comm'r of Taxes of Vt.*, 445 U.S. 425 (1980) (upholding an income tax); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 623-24 (1981) (upholding coal severance taxes); *Goldberg v. Sweet*, 488 U.S. 252 (1989) (addressing telecommunications excise taxes)). And the analysis in these cases focuses on the in-state physical activities of the taxpayer or its representative, not the general economic benefit derived from customers within the state. *See, e.g.*, *Tyler Pipe*, 483 U.S. at 249-51; *see also Nw. States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 454-55, 464-65 (1959).

Further, although *Quill* itself involved sales and use tax collection obligations, the fundamental "constitutional question in . . . *Quill*" was—as this Court subsequently observed—the *general* question "whether the State has the authority to tax the corporation *at all*" under the Commerce Clause. *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768, 778 (1992) (emphasis added). And while the Court in *Complete Auto* synthesized its Commerce Clause taxation analysis into a generally applicable four-part test, nothing in *Complete Auto* (or any subsequent case) suggests that the "substantial nexus" prong of the test can vary based solely on the type (or label) of tax at issue. To the contrary, in discussing the Commerce Clause nexus requirement, this Court has routinely referred to cases involving sales and use taxes interchangeably with cases involving direct taxes such as income and franchise taxes. *See, e.g., Nat'l Geographic Soc'y v. California Bd. of Equalization*, 430 U.S. 551, 555-59 (1977). There is thus no basis in this Court's jurisprudence for treating sales and use taxes differently from other taxes for purposes of the Commerce Clause, and nothing in *Quill* that supports eliminating the physical presence rule outside the context of sales and use tax.

B. A Bright-Line Physical Presence Rule Applicable To All Taxes Settles Expectations, Fosters Investment, And Promotes Interstate Commerce

If anything, *Quill*'s reasons for reaffirming application of the physical presence rule to sales and use taxes apply even more strongly to the income and franchise taxes at issue in this case. To begin, the *Quill* court recognized that a strong reliance interest had arisen around the physical presence rule enunciated in *Bellas Hess*, which had become "part of the basic framework of [the] sizeable [mail-order] industry." 504 U.S. at 317. Such reliance, the Court observed, was a key respect in which the bright-line physical presence rule "furthers the ends of the dormant Commerce Clause," by "encourag[ing] settled expectations" and "foster[ing] investment by businesses and individuals." *Id.* at 314-16.

The same reasoning applies here. As in the sales and use context, interstate businesses have already developed a degree of reliance on the physical presence rule. As noted earlier, physical presence has traditionally been the governing limit on state taxation authority. In 1993, the *Gillette* and *Guardian* cases in Michigan expressed the widely-held understanding of the business community that *Quill* had reaffirmed the broadly applicable physical presence rule in the face of a "changed modern marketplace" argument, and that the type of tax at issue in *Quill* did not limit the rule's scope. Despite the strained misinterpretations of *Quill* by the South Carolina Supreme Court and others, many taxpayers (and numerous states) have relied upon the physical presence rule as the only workable, principled rule for limiting income tax jurisdiction (absent a more detailed legislative resolution that Congress has, to date, declined to provide). This reliance was grounded not simply in *Quill* but also on the understanding, noted above, that this Court has never upheld a state tax in the absence of physical presence, and that the Court's nexus analysis in state taxation cases has always focused on the in-state physical activities of the taxpayer or its representative.

Since *Quill* was decided in 1992, the market has witnessed the growth of much more than just the mail order industry that concerned the Court in *Quill*. The interstate banking industry, of which MBNA is a part, has grown and flourished based upon a number of factors, including not only deregulation and technological innovation, but also reliance on this Court's unbroken record of subjecting out-of-state corporations to tax only if they have in-state physical presence. And of course the Internet has facilitated the growth of a huge sector of the economy: businesses, often small in scale, that can market themselves and their products online in all fifty states (and throughout the world) with minimal overhead. If the large mail-order catalog houses of decades past relied on the physical presence rule to clarify their state taxation burdens, that is all the more true of the

online businesses that are the backbone of modern e-commerce. As in *Quill*, abandoning the physical presence rule would upset these various reliance interests and harm important commerce in the financial services and online industries, as well as others.

C. Abandoning The Physical Presence Rule Will Impose Severe Burdens On Interstate Commerce, Undermining The Purpose Of The Commerce Clause

The Court in *Quill* was also concerned that abandoning the physical presence rule and permitting widespread imposition of tax liability might "unduly burden interstate commerce" in violation of the fundamental purposes of the Commerce Clause. *Quill*, 504 U.S. at 313. Noting that the North Dakota law at issue in *Quill* imposed a collection duty on every vendor who advertised in the state three times in a single year, the Court observed:

> absent the *Bellas Hess* rule, a publisher who included a subscription card in three issues of its magazine, a vendor whose radio advertisements were heard in North Dakota on three occasions, and a corporation whose telephone sales force made three calls into the State, all would be subject to the collection duty. What is more significant, similar obligations might be imposed by the Nation's 6,000-plus taxing jurisdictions.

Id. at 313 n.6.

These considerations apply with even greater force to the income and franchise taxes at issue in this case. As this Court has recognized, the burden on interstate commerce imposed by direct taxes such as income and franchise taxes is greater than that imposed by indirect sales and use tax collection obligations, because unlike collection obligations, direct taxes impose both administrative *and financial* burdens on taxpayers. *See Nat'l Geographic*, 430 U.S. at 558. Moreover, because income and franchise taxes actually im-

pose payment obligations on the taxpayer, they exacerbate the risk that taxpayers will be taxed multiple times on the same revenue. *Id.*

And, like in *Quill*, the compliance burden imposed by abandoning the physical presence rule for income and franchise taxation would be staggering. As the West Virginia Supreme Court's decision in this case illustrates, absent a physical presence rule, businesses may be subjected to income and franchise taxes virtually anywhere they have customers. As the chart reproduced in the Appendix indicates, there are at present more than *2000 different* income, franchise, and gross receipts taxes imposed on businesses nationwide by state and local jurisdictions. App. 83a. Even more striking, there are more than eight thousand different potential direct taxing jurisdictions across the country, which collectively have the authority to impose more than *12,600* different direct tax obligations. App. 78a, 83a. Accordingly, if this Court were to abandon the physical presence rule for income and state taxation, interstate businesses could be subject to more than 12,600 different direct taxes throughout the United States.

Furthermore, contrary to the West Virginia Supreme Court's inexplicable assertion, *see* App. 16a-17a, the burdens of complying with income and franchise tax laws are at least as onerous as those associated with the sales and use tax collection obligations in *Quill*. Income tax compliance involves understanding and applying apportionment formulae, sourcing and inclusion definitions, legal entity classification, income classification, depreciation, disclosure requirements, and numerous other elements. And each of these elements varies widely among the thousands of potential direct taxing jurisdictions with which corporations would have to file returns. The result would be—and to a great degree already is—a bewildering array of differing rules that would generate enormous compliance costs.

As the *Quill* court noted, the Framers intended the Commerce Clause as a "cure for th[e] structural ills" of "state

taxes and duties" that "hindered and suppressed interstate commerce" under the Articles of Confederation. 504 U.S. at 312-13; *see supra* note 1. The Commerce Clause's nexus requirement is intended to achieve this purpose by "limit[ing] the reach of state taxing authority so as to ensure that state taxation does not unduly burden interstate commerce." 504 U.S. at 313. Abandoning the clear physical presence rule in favor of vague "economic presence" principles would have exactly the opposite effect, burying interstate businesses in the very "welter of complicated obligations" the Commerce Clause was meant to avoid. *Bellas Hess*, 386 U.S. at 759-60.

D. The Physical Presence Rule Fortifies The Integrity Of Sovereign States

The physical presence rule also embodies the concept of territorial sovereignty that underlies the federal system. Reaffirming that rule would thus fortify this Court's recent insistence on the continuing relevance of state boundaries even in light of modern market realities.

In its opinion below, the West Virginia Supreme Court of Appeals suggested that the "development and proliferation" of various kinds of technology, App. 17a, and the "complex and varied ways" in which commerce is now conducted, App. 22a, have rendered physical presence within a state's borders a "poor measuring stick of an entity's true nexus with a state," App. 18a. The court therefore decided to "eschew" the "rigid and mechanical legal formul[a]" articulated in *Bellas Hess* and *Quill* in favor of "a fresh application of Commerce Clause principles tempered with healthy doses of fairness and common sense." App. 22a. Such an application, it concluded, permitted it to reach out and tax MBNA, a resident of Delaware that had already paid millions of dollars in taxes to its home state.

As discussed, the West Virginia court's analysis ignores the numerous reasons why a bright-line physical presence rule continues to play an essential role in ensuring a free

flow of interstate commerce even in "today's world." App. 17a. But more fundamentally, the West Virginia court's "changed circumstances" argument attacks the concept of territorial sovereignty that underlies the very idea of a state. In essence, the court held that because modern economic transactions cross borders with ease, geographical boundaries are less important than they once were, and therefore no longer can serve as the foundation for viable legal rules.

That argument fundamentally contradicts this Court's many recent cases reaffirming the importance of geographic state boundaries. Even in cases involving economic transactions in borderless markets, this Court has insisted that state power does not extend beyond state borders, and that the physical location of relevant actors and events matters. *See, e.g.*, *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 421 (2003); *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 569-71 (1996); *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 821-23 (1985).

The physical presence rule reinforces the idea of territorial sovereignty in the context of state taxation by ensuring that the physical location of taxpayers is the decisive factor in determining which sovereigns are entitled to tax which corporations. That rule ensures that each state has access to the revenue base of corporate income within its borders, without interference from other states seeking additional sources of revenue. It also permits states to protect their own taxpayers from burdensome foreign taxation. To say that physical location within a state matters, in other words, is to say that states themselves matter.

E. Physical Presence Is An Appropriate And Judicially Manageable Default Rule

The physical presence rule is also easy to apply, and confers a strong measure of certainty and predictability on the limits of state taxation authority. Taxing authorities and courts have been applying the rule for years, *see, e.g.*, *Tyler Pipe*, 483 U.S. at 250-51, and it has proved capable of estab-

lishing "settled expectations," encouraging investment, and fostering interstate commerce. *Quill*, 504 U.S. at 316; *see id.* at 321 (Scalia, J., concurring) (concern about a "flurry of litigation over the meaning of 'physical presence' seems to me contradicted by 25 years of experience") (citation omitted).

The various types of "economic presence" principles invoked by West Virginia and other states, in contrast, are judicially unmanageable and wholly unsuited to the purposes of the Commerce Clause. "Economic presence," to begin with, does not even describe a single legal test: under this rubric, states have imposed a wide variety of different nexus standards, from those applicable only to the in-state presence of intangible property held by affiliates, to the sweeping assertion of extraterritorial jurisdiction at issue in this case.

What is more, courts are particularly ill-suited to determining what that concept means. Relying vaguely on "economic presence" to justify an extraterritorial tax requires courts to decide how many and what type of contacts with a state create a constitutionally adequate nexus while still avoiding harm to interstate commerce. Any number of factors, alone or in combination, could affect that calculus—number of sales, quantity of goods sold, dollar value of sales, advertising investments, and so on. There is simply no judicially manageable basis on which courts can decide which of these contacts matters, and how much they matter. With such a vaguely defined inquiry, it is a virtual certainty that like taxation cases will *not* be treated alike, contrary to the essential function of the judiciary.

"Economic presence," moreover, provides no meaningful conceptual limits on state taxation authority, as the West Virginia court's decision in this case makes clear. Contrary to that court's statement, "economic presence" does not replace a "rigid and mechanical" rule, App. 22a, with an "elastic" standard, App. 20a. Rather, it replaces a well-established, manageable rule with a principle that is insusceptible to

meaningful definition, much less coherent judicial application.

As the Court recognized in *Quill*, the ultimate authority to regulate interstate commerce lies with Congress. *See Quill*, 504 U.S. at 318-19. But absent congressional action, this Court can and must apply a manageable default rule to limit the state taxation schemes that threaten to impede the free flow of interstate commerce. The current uncertainty is untenable. A clear Commerce Clause rule must be adopted, and the only rule courts have the capacity to manage is the physical presence rule. If Congress were to regard that rule as functionally overbroad or insufficiently nuanced, it could replace it with a statutory scheme providing specific, identifiable criteria authorizing state taxation, as well as safe harbors or exceptions applicable in particular situations. But courts obviously cannot establish such reticulated standards—those are inherently the province of legislative action. What courts can do is to apply clear and specific standards like the physical presence rule, which has been the rule governing state taxation for decades. This Court has expressly endorsed that rule twice, and Congress has never acted to alter it. As long experience shows, the physical presence rule provides more than enough clarity and certainty to encourage reliance and investment, thereby promoting the free flow of commerce between the states. For the same reasons recognized in *Quill*, in short, physical presence is the only rule courts can and should apply in Commerce Clause challenges to state taxation schemes.

CONCLUSION

For the foregoing reasons, the petition should be granted.

Respectfully submitted,

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March 8, 2007

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APPENDIX A

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

September 2006 Term

No. 33049

TAX COMMISSIONER OF THE STATE OF WEST VIRGINIA,

Petitioner Below, Appellee

v.

MBNA AMERICA BANK, N.A.,

Respondent Below, Appellant

Appeal from the Circuit Court of Kanawha County
Honorable Louis H. Bloom, Judge
Civil Action No. 04-AA-157

AFFIRMED

Submitted: September 19, 2006
Filed: November 21, 2006

JUSTICE MAYNARD delivered the Opinion of the Court.
CHIEF JUSTICE DAVIS concurs and reserves the right to file a concurring opinion.
JUSTICE BENJAMIN dissents and reserves the right to file a dissenting opinion.

SYLLABUS BY THE COURT

1. "A state tax on interstate commerce will not be sustained unless it: '(1) has a substantial nexus with the State; (2) is fairly apportioned; (3) does not discriminate; and (4) is fairly related to the services provided by the State.' *Maryland v. Louisiana,* [451] U.S. [725], [754], 101 S.Ct. 2114, 2133, 68 L.Ed.2d 576 (1981)." Syllabus Point 1, *Western Maryland Ry. Co. v. Goodwin,* 167 W.Va. 804, 282 S.E.2d 240 (1981).

2. The United States Supreme Court's determination in *Quill Corp. v. North Dakota,* 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992), that an entity's physical presence in a state is required to meet the "substantial nexus" prong of *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977), applies only to state sales and use taxes and not to state business franchise and corporation net income taxes.

Maynard, Justice:

Appellant MBNA America Bank appeals the June 27, 2005, order of the Circuit Court of Kanawha County that ruled that imposition of West Virginia's business franchise tax and corporation net income tax on MBNA, a Delaware Corporation, for tax years 1998 and 1999, does not violate the Commerce Clause. For the reasons that follow, we affirm the circuit court.

I.

FACTS

Appellant MBNA America Bank is a foreign corporation which has its principal place of business and commercial domicile in Wilmington, Delaware. During the two years in

question, 1998 and 1999, MBNA had no real or tangible personal property and no employees located in West Virginia. The principal business of MBNA at the relevant times in this case was issuing and servicing VISA and MasterCard credit cards. This business included the extension of unsecured credit to customers who use these credit cards. MBNA promoted its business in West Virginia via mail and telephone solicitation.

As noted above, the two tax years at issue are 1998 and 1999. In 1998, MBNA's gross receipts attributable to West Virginia customers amounted to $8,419,431.00, and in 1999, its gross receipts amounted to $10,163,788.00. For tax year 1998, MBNA paid a West Virginia Business Franchise Tax[1] of $32,010.00 and a West Virginia Corporation Net Income tax[2] of $168,034.00. For tax year 1999, MBNA paid a Business Franchise Tax in the amount of $42,339.00 and a Corporation Net Income Tax in the amount of $220,897.00.

Thereafter, MBNA filed refund claims with the State Tax Commissioner seeking the return of the business franchise and corporation net income taxes paid for 1998 and 1999, on the basis that the Tax Commissioner lacked jurisdiction over MBNA. The Commissioner denied the refunds based on its finding that MBNA regularly engaged in business in West Virginia under the applicable statutes.[3]

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[1] The West Virginia Business Franchise Tax is found in W.Va. Code §§ 11-23-1, *et seq*. According to W.Va. Code § 11-23-1 (1985) the tax is imposed on corporations and partnerships for the privilege of doing business in this state.

[2] The West Virginia Corporation Net Income Tax is found in W.Va. Code §§ 11-24-1, *et seq*.

[3] The statutory nexus required for the business franchise tax is found in W.Va. Code § 11-23-5a(d) (1996), which states in part:

> A financial organization that has its commercial domicile in another state is presumed to be regularly engaging in business in

MBNA subsequently filed an appeal from the Tax Commissioner's decision with the Office of Tax Appeals (hereafter "OTA"). By decision dated October 22, 2004, the Chief Administrative Law Judge (hereafter "ALJ") of the OTA ruled in favor of MBNA and authorized refunds to MBNA of its 1998 and 1999 franchise and corporation net income taxes. The ALJ reasoned that under the Commerce Clause, a state may not subject an activity to a tax unless that activity has a "substantial nexus" with the taxing state. The ALJ further reasoned that a substantial nexus requires a finding that the putative taxpayer has a physical presence in the taxing state, and mere economic exploitation of the market is not sufficient. Because it was agreed that MBNA does not have a physical presence in West Virginia, the ALJ concluded that the State's business franchise and corporation net income taxes could not be imposed on MBNA's activity within the State.

The Tax Commissioner appealed the ALJ's decision to the Circuit Court of Kanawha County. The circuit court reversed the decision of the ALJ. According to the circuit court, physical presence is not necessary in order to show a substantial nexus for purposes of state taxation of foreign

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> this state if during any year it obtains or solicits business with twenty or more persons within this state, or if the sum of the value of its gross receipts attributable to sources in this state equals or exceeds one hundred thousand dollars.

The statutory nexus required for the West Virginia corporation net income tax is found in W.Va. Code § 11-24-7b(d) (1996) which provides in part:

> A financial organization that has its commercial domicile in another state is presumed to be regularly engaging in business in this state if during any year it obtains or solicits business with twenty or more persons within this state, or if the sum of the value of its gross receipts attributable to sources in this state equals or exceeds one hundred thousand dollars.

corporations. Rather, the circuit court found that MBNA's significant business in the state is sufficient to meet the substantial nexus standard. Therefore, concluded the circuit court, MBNA had a substantial nexus with West Virginia during the tax years in question so that imposition of the State's business franchise and corporate net income taxes on MBNA did not violate the Commerce Clause. MBNA now appeals the circuit court's order.

II.

STANDARD OF REVIEW

The Court has previously recognized that a lower court's determination of whether a state tax violates the Commerce Clause is reviewed *de novo. See Hartley Marine Corp. v. Mierke,* 196 W.Va. 669, 474 S.E.2d 599 (1996) (explaining that review of lower court judgment on whether state legislation interferes with free flow of interstate commerce is *de novo*).

III.

DISCUSSION

The single issue[4] raised in this appeal is whether application of West Virginia's business franchise and corporation net income taxes to MBNA, a business with no physical presence in this state, violates the Commerce Clause of the United States Constitution.[5] In Article 1, § 8 of the United

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[4] In its petition for appeal to this Court, MBNA also raised an assignment of error concerning fair apportionment of the taxes at issue. However, MBNA subsequently abandoned this assignment of error.

[5] We are mindful that our task herein is a difficult one. The United States Supreme Court has acknowledged that its dormant Commerce Clause law "is something of a 'quagmire' and the 'application of constitutional principles to specific state statutes leaves much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their indispensable power of taxation.'" *Quill Corp. v.*

States Constitution, Congress is expressly granted the authority "[t]o regulate Commerce with foreign Nations, and among the several States."[6] The Supreme Court has deter-

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North Dakota, 504 U.S. 298, 315-316, 112 S.Ct. 1904, 1915, 119 L.Ed.2d 91 (1992) (*quoting Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 457-458, 79 S.Ct. 357, 362, 3 L.Ed.2d 421 (1959). Likewise, this Court has characterized this area of the law as "nebulous at best," *Hartley Marine Corp.*, 196 W.Va. at 677, 474 S.E.2d at 607, and commented that,

> It would be a Herculean, if not impossible task, to review and harmonize the myriad decisions of the Supreme Court of the United States on the subject of interstate commerce and exactly what incidents thereof may be constitutionally taxed by the States. The dissenting opinions in many of those cases make clear that the task of reconciling all the decisions is more difficult than was the task of Theseus as he threaded his way through the famous Cretan Labyrinth in search of the Minotaur.

J.C. Penney Co., Inc. v. Hardesty, 164 W.Va. 525, 527, 264 S.E.2d 604, 607 (1979) (*quoting Roy Stone Transfer Corp. v. Messner*, 377 Pa. 234, 243-44, 103 A.2d 700, 705 (1954)).

[6] An example of Congress's regulation of interstate commerce is found in 15 U.S.C. § 381(a) (2000), which provides that,

> No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:
>
> (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and
>
> (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

mined that the Commerce Clause, in addition to being a positive grant of power to Congress, also acts to prevent certain state regulation that interferes with interstate commerce. *See South Carolina State Highway Dept. v. Barnwell Bros., Inc.*, 303 U.S. 177, 58 S.Ct. 510, 82 L.Ed. 734 (1938). This prohibition on state action is known as the "negative" or "dormant" Commerce Clause.

The Supreme Court's interpretation of the dormant Commerce Clause "has evolved substantially over the years, particularly as that Clause concerns limitations on state taxation powers." *Quill Corp. v. North Dakota*, 504 U.S. 298, 309, 112 S.Ct. 1904, 1911, 119 L.Ed.2d 91 (1992) (citation omitted). In tracing this evolution, the Court has explained:

> Our early cases, beginning with *Brown v. Maryland*, 12 Wheat. 419, 6 L.Ed. 678 (1827), swept broadly, and in *Leloup v. Port of Mobile*, 127 U.S. 640, 648, 8 S.Ct. 1380, 1384, 32 L.Ed. 311 (1888), we declared that "no State has the right to lay a tax on interstate commerce in any form." We later narrowed that rule and distinguished between direct burdens on interstate commerce, which were prohibited, and indirect burdens, which generally were not. *See, e.g., Sanford v. Poe*, 69 F. 546 (CA 6 1895), *aff'd sub. nom., Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194, 220 (1897). *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 256-258, 58 S.Ct. 546, 549-550, 82 L.Ed. 823 (1938), and subsequent decisions rejected this formal, categorical analysis and adopted a

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Of relevance to the instant case is the fact that in the last two years bills have been introduced in both houses of Congress to amend 15 U.S.C. § 381 to apply to, in addition to tangible property, all other forms of property, services, and other transactions fulfilled from a point outside the State. *See* H.R. 1956, 109th Congress (April 28, 2005); H.R. 4845, 109th Congress (March 2, 2006); S. 2721, 109th Congress (May 4, 2006). These bills have not been enacted into law.

> "multiple-taxation doctrine" that focused not on whether a tax was "direct" or "indirect" but rather on whether a tax subjected interstate commerce to a risk of multiple taxation. However, in *Freeman v. Hewit,* 329 U.S. 249, 256, 67 S.Ct. 274, 278, 91 L.Ed. 265 (1946), we embraced again the formal distinction between direct and indirect taxation, invalidating Indiana's imposition of a gross receipts tax on a particular transaction because that application would "impos[e] a direct tax on interstate sales."

Quill, 504 U.S. at 309-310, 112 S.Ct. at 1911. The Court subsequently abandoned formal distinctions in favor of looking at the practical effects of state taxing statutes. In *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977), the Court set forth the current test for determining whether a state tax violated the Commerce Clause. This Court recognized the *Complete Auto* test in Syllabus Point 1 of *Western Maryland Ry. Co. v. Goodwin,* 167 W.Va. 804, 282 S E.2d 240 (1981), where we held that,

> A state tax on interstate commerce will not be sustained unless it: "(1) has a substantial nexus with the State; (2) is fairly apportioned; (3) does not discriminate; and (4) is fairly related to the services provided by the State." *Maryland v. Louisiana,* [451] U.S. [725], [754], 101 S.Ct. 2114, 2133, 68 L.Ed.2d 576 (1981).[7] (Footnote added).

The current issue deals solely with the "substantial nexus" prong of the *Complete Auto* test. Specifically, we are asked to decide whether the substantial nexus standard can only be met by showing that the putative taxpayer has an

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[7] This test is referred to in *Maryland v. Louisiana* as the *Complete Auto* test and is generally known by that name. Therefore, we refer to it as the *Complete Auto* test in this opinion.

actual physical presence in the taxing state. In answering this question, we must consider the Supreme Court's decisions in *National Bellas Hess, Inc. v. Department of Revenue,* 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967), *overruled, in part, Quill supra,*[8] and *Quill,* the Court's most recent pronouncement on state tax jurisdiction.

Bellas Hess involved an attempt by Illinois to require a mail-order business to collect and pay use taxes on goods purchased within the state. National Bellas Hess (hereinafter "National") was incorporated in Delaware and had its principal place of business in Missouri. It had neither outlets nor employees in Illinois. Twice a year, National mailed catalogues to the company's customers in Illinois. Orders for merchandise were mailed by customers to National's Missouri plant, and the ordered items were mailed to the customers either by mail or common carrier. National challenged the Illinois use tax levied against it on the basis, *inter alia,* that it created an unconstitutional burden on interstate commerce. The Supreme Court held that Illinois had no power to impose the use tax on National. The Court based its decision in part on the undue burden placed on interstate commerce by compliance with a host of administrative regulations governing the collection of sales and use taxes.

In 1992, the Supreme Court reaffirmed in *Quill* its *Bellas Hess* holding to the extent that *Bellas Hess* held that a showing of the taxpayer's physical presence in the taxing state was necessary to sustain a sales and use tax against a challenge under the Commerce Clause.[9] Quill was a Delaware corporation with offices and warehouses in Illinois, Califor-

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[8] *Quill* overruled *Bellas Hess* to the extent that *Bellas Hess* held that a showing of the taxpayer's physical presence in the taxing state was necessary to sustain the constitutionality of a sales and use tax against a challenge under the Due Process clause.

[9] *See* fn. 8, *infra.*

nia, and Georgia. It sold office equipment and supplies, and solicited business through catalogs, flyers, advertisements in national periodicals, and telephone calls. Customers received their ordered merchandise from Quill through mail or common carrier. Despite the fact that Quill had no employees in North Dakota, and that its tangible property in North Dakota was "either insignificant or nonexistent," 504 U.S. at 302, 112 S.Ct. at 1907, Quill was required to collect a use and sales tax from its North Dakota customers and remit it to the state. Quill challenged imposition of the tax on the ground that North Dakota did not have the power to compel it to collect a use tax from its North Dakota customers.

In addressing this issue, the Supreme Court first indicated that in determining the propriety of a state use tax on an out-of-state corporation "the nexus requirements of the Due Process and Commerce Clauses are not identical." 504 U.S. at 312, 112 S.Ct. at 1913.[10] The analysis under the Due Process Clause, explained the Court, is comparable to that used in determining whether a State can exercise personal jurisdiction over a person. Specifically, there must be "some definite link, some minimum connection, between a state and the person, property, or transaction it seeks to tax." 504 U.S. at 306, 112 S.Ct. at 1909 (*quoting Miller Brothers Co. v. Maryland,* 347 U.S. 340, 344-345, 74 S.Ct. 535, 539, 98 L.Ed. 744 (1954)). This is in order to ensure that imposition of a duty to collect a use tax on an out-of- state corporation does not offend traditional notions of fairness. Further, the Court found that the minimum connection is satisfied where the business "is engaged in continuous and widespread solicitation of business within a State[] [because] [s]uch a cor-

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[10] "*Quill* . . . was the first [Supreme Court] decision to bifurcate the Due Process and Commerce Clause analyses used to determine a state's jurisdiction to tax under the U.S. Constitution." Christina R. Edson, *Quill's Constitutional Jurisprudence And Tax Nexus Standards In An Age Of Electronic Commerce* 49 Tax Lawyer 893, 894 (Summer 1996).

poration clearly has fair warning that [its] activity may subject [it] to the jurisdiction of the foreign sovereign." 504 U.S. at 308, 112 S.Ct. at 1911 (internal quotation marks and citations omitted). The Court concluded that the Due Process Clause does not require physical presence in a State for the imposition of a duty to collect a use tax.

The Commerce Clause and its nexus requirement, in contrast, explained the Court, "are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy. . . . Accordingly, we have ruled that [the Commerce] Clause . . . bars state regulations that unduly burden interstate commerce." 504 U.S. at 312, 112 S.Ct. at 1913. (Citations omitted). "Thus, 'the substantial nexus' requirement is . . . a means for limiting state burdens on interstate conference." 504 U.S. at 313, 112 S.Ct. at 1913. The *Quill* Court ultimately concluded that for purposes of imposing on an out-of-state business the duty of collecting use and sales taxes on in-state customers, the *Complete Auto* substantial nexus prong would best be determined by application of a "bright-line, physical-presence requirement." 504 U.S. at 317, 112 S.Ct. at 1916.

The major question left open by the Supreme Court's opinion in *Quill* is the one that now confronts us: Does the physical presence requirement applicable to determining the constitutionality of requiring out-of-state mail-order houses to collect use taxes on in-state sales under the Commerce Clause extend to other types of state taxes? MBNA's position is that *Quill* extends to the business franchise and corporation net income taxes at issue. The Tax Commissioner posits, on the other hand, that physical presence is not a re-

quirement of the substantial nexus standard in regards to the taxes at issue.[11]

After careful consideration of the parties' arguments, the relevant legal authority, and the Court's reasoning in *Quill,* we conclude that *Quill's* physical-presence requirement for showing a substantial Commerce Clause nexus applies only to use and sales taxes and not to business franchise and corporation net income taxes. There are several reasons for our conclusion. First, we agree with the Tax Commissioner that a close reading of *Quill* indicates that its reaffirmation of the *Bellas Hess* physical-presence test for use and sales taxes under the Commerce Clause is grounded primarily on *stare decisis.* For example, the Court in *Quill* notes that "[w]hile contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today, *Bellas Hess* is not inconsistent with *Complete Auto* and our recent cases." *Quill,* 504 U.S. at 311, 112 S.Ct. at 1912. The Court further indicated that "the *Bellas Hess* rule has engendered substantial reliance and has become part

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[11] The Tax Commissioner cites several cases to this Court in support of its position that *Quill's* physical-presence requirement applies only to sales and use taxes including *Lanco, Inc. v. Director of Taxation,* 379 N.J.Super. 562, 879 A.2d 1234 (2005); *A&F Trademark, Inc. v. Tolson,* 167 N.C.App. 150, 605 S.E.2d 187 (2004), *cert. denied,* __ U.S. __, 126 S.Ct. 353, 163 L.Ed.2d 62 (2005); *Secretary, Dep't of Revenue, State of La. v. Gap (Apparel), Inc.,* 886 So.2d 459 (La.App. 2004); and *Geoffrey, Inc. v. S.C. Tax Com'n,* 313 S.C. 15, 437 S.E.2d 13 (1993). We find the persuasiveness of these cases to be limited, however, because the primary issue in each case is whether a state has jurisdiction to impose a state income tax on foreign corporations with no physical presence in the taxing state but whose intangibles, such as a trademark, are used in the state by a licensee. These courts reason, in part, that the intangibles located in the state provide a sufficient nexus for income tax purposes. In the instant case, there is no claim that MBNA has intangibles in West Virginia that provide a sufficient nexus for tax purposes.

of the basic framework of a sizable industry. The interest in stability and orderly development of the law that undergirds the doctrine of *stare decisis* therefore counsels adherence to settled precedent." *Id.*, 504 U.S. at 317, 112 S.Ct. at 1916 (internal quotations and citation omitted). Finally, the Court concluded that "the continuing value of a bright-line rule in this area and the doctrine and principles of *stare decisis* indicate that the *Bellas Hess* rule remains good law." *Id.*

This reasoning is supported by several legal commentators. *See* John A. Swain, *State Income Tax Jurisdiction: A Jurisprudential and Policy Perspective,* 45 Wm. & Mary L.Rev. 319 (October 2003) (arguing that the *Quill* Court relied on *stare decisis* rather than defending the physical presence test on the merits); Richard D. Pomp & Michael J. McIntyre, *State Taxation of Mail-Order Sales of Computers After Quill: An Evaluation of MTC Bulletin 95-1,* 11 State Tax Notes 177, 179-80 (July 15, 1996) (maintaining that *Quill* is essentially a political decision responding to concerns about retroactivity and the practical consequences of overruling *Bellas Hess*); Michael T. Fatale, *State Tax Jurisdiction and the Mythical "Physical Presence" Constitutional Standard,* 54 Tax Lawyer 105, 113 (Fall, 2000) (opining that "[a] primary basis for the [*Quill*] holding was the Court's conclusion that the mail order industry had grown in large part in reliance on *Bellas Hess*[,] [and] [b]ecause the *Bellas Hess* rule had become the 'basic framework' of a sizable industry) (footnotes omitted). Thus, because *Quill's* physical-presence test for sales and use taxes was based in large part on the mail order industry's reliance on *Bellas Hess,* we are not compelled to apply *Quill's* physical presence standard to the present circumstances.

Second, the Supreme Court appears to have expressly limited *Quill's* scope to sales and use taxes. First, the *Quill* Court noted that "[a]lthough we have not, in our review of other types of taxes, articulated the same physical-presence

requirement that *Bellas Hess* established for sales and use taxes, that silence does not imply repudiation of the *Bellas Hess* rule." *Quill,* 504 U.S. at 314, 112 S.Ct. at 1914. Also, the Court commented that "although in our cases subsequent to *Bellas Hess* and concerning other types of taxes we have not adopted a similar bright-line, physical-presence requirement, our reasoning in those cases does not compel that we now reject the rule that *Bellas Hess* established in the area of sales and use taxes." *Id.,* 504 U.S. at 317, 112 S.Ct. at 1916. We believe that a reasonable construction of this language clearly implies that *Quill* applies only to sales and use taxes and not to other types of state taxes.[12]

Third, the *Bellas Hess* and *Quill* courts based their decisions in part on the fact that compliance with administrative regulations in the collection of sales and use taxes places an undue burden on interstate commerce. Specifically, the *Bellas Hess* Court explained:

> In order to uphold the power of Illinois to impose use tax burdens on National in this case, we would have to repudiate totally the sharp distinction . . . between mail order sellers with retail outlets, solicitors, or property within a State, and those who do no more

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[12] One legal commentator has interpreted these portions of the *Quill* opinion to mean that,

> the Commerce Clause's physical presence requirement was not necessarily applicable to other tax types nor dictated by sound Commerce Clause jurisprudence and that the Court was motivated by principles of stare decisis flowing from *Bellas Hess.* It appears the Court intentionally left itself open for future decisions involving other types of taxes. Therefore, *Quill's* physical presence requirement may not apply to future non-use tax collection decisions.

Edson, 49 Tax Lawyer at 925.

> than communicate with customers in the State by mail or common carrier as part of a general interstate business. But this basic distinction, which until now has been generally recognized by the state taxing authorities, is a valid one, and we decline to obliterate it.
>
> . . . For if Illinois can impose such burdens, so can every other State, and so, indeed, can every municipality, every school district, and every other political subdivision throughout the Nation with power to impose sales and use taxes. The many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle National's interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose a fair share of the cost of the local government.
>
> The very purpose of the Commerce Clause was to ensure a national economy free from such unjustifiable local entanglements. Under the Constitution, this is a domain where Congress alone has the power of regulation and control.

Bellas Hess, 386 U.S. at 758-760, 87 S.Ct. at 1392-1393 (internal quotation marks and footnotes omitted). According to the Court, at the time *Bellas Hess* was decided, local sales taxes were imposed by over 2,300 localities, many of them accompanied by a use tax, utilizing several different rates. *Id.*, 386 U.S. at 759 fn. 12 and fn. 13, 87 S.Ct. at 1393 fn. 12 and fn. 13.[13]

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[13] In Edson, 49 Tax Lawyer at 911, it is noted that in 1996, when that article was written, there were over 6,100 state and local jurisdictions that imposed sales taxes using varied tax rates.

The *Quill* Court likewise recognized the potential burden on interstate commerce posed by North Dakota's sales and use taxes.

> North Dakota's use tax illustrates well how a state tax might unduly burden interstate commerce. On its face, North Dakota law imposes a collection duty on every vendor who advertises in the State three times in a single year. Thus, absent the *Bellas Hess* rule, a publisher who included a subscription card in three issues of its magazine, a vendor whose radio advertisements were heard in North Dakota on three occasions, and a corporation whose telephone sales force made three calls into the State, all would be subject to the collection duty. What is more significant, similar obligations might be imposed by the Nation's 6,000- plus taxing jurisdictions.

Quill, 504 U.S. at 313 fn. 6, 112 S.Ct. at 1913 fn. 6, *citing Bellas Hess,* 386 U.S. at 759-760, 87 S.Ct. at 1393 (noting that the "many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle [a mail-order house] in a virtual welter of complicated obligations") (additional citation omitted).

In contrast to the sales and use taxes described in *Bellas Hess* and *Quill,* the franchise and income taxes at issue in this case do not appear to cause the same degree of compliance burdens. As noted above, the task of collecting taxes and remitting them to the government demands knowledge of a multitude of administrative regulations, including various deductions and tax rates, as well as record-keeping requirements. Also, as a general matter, sales and use taxes must be remitted to the government on a more frequent basis than income and franchise taxes. For example, in West Virginia vendors are charged with the duty of collecting from purchasers the consumer sales and service tax and paying the tax to the Tax Commissioner on a monthly basis. This entails

making out and mailing to the Commissioner a return for the preceding month on a prescribed form showing the total gross proceeds of the vendor's business during that time, the gross proceeds of the vendor's business upon which the tax is based, the amount of the tax for which the vendor is liable, and any further information necessary in the computation and collection of the tax which the Commissioner may require. *See* W.Va. Code § 11-15-16 (2003). In contrast, income and franchise taxes are paid by the business entity itself so that no collection duties are involved. Also, income and franchise taxes are generally paid annually. *See e.g.*, W.Va. Code § 11- 23-9 (1996) (persons subject to business franchise tax shall make and file an annual return) and W.Va. Code § 11-24-13 (1993)[14] (requiring annual filing of corporation net income tax return).[15]

Finally, we believe that the *Bellas Hess* physical-presence test, articulated in 1967, makes little sense in today's world. In the previous almost forty years, business practices have changed dramatically. When *Bellas Hess* was decided, it was generally necessary that an entity have a physical presence of some sort, such as a warehouse, office, or salesperson, in a state in order to generate substantial business in that state. This is no longer true. The development and proliferation of communication technology exhibited, for example, by the growth of electronic commerce now makes it possible for an entity to have a significant economic presence in a state absent any physical presence there. For this reason, we believe that the mechanical application of a

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[14] We note, however, that taxpayers whose liability for these taxes exceeds a specified amount are charged with paying estimated taxes for the taxable year on a quarterly basis. *See* W.Va. Code § 11-23-13 (1987).

[15] Of course, administrative regulations involved in the payment of any type of tax most likely would not be a concern today due to the common use of computers and the availability of specialized software.

physical-presence standard to franchise and income taxes is a poor measuring stick of an entity's true nexus with a state.

Accordingly, we now hold that the United States Supreme Court's determination in *Quill Corp. v. North Dakota,* 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992), that an entity's physical presence in a state is required to meet the "substantial nexus" prong of *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977), applies only to state sales and use taxes and not to state business franchise and corporation net income taxes.

Rather than a physical presence standard, this Court believes that a significant economic presence test is a better indicator of whether substantial nexus exists for Commerce Clause purposes. At least one legal commentator has suggested such a test and to some degree defined its parameters. *See* Edson, 49 Tax Lawyer at 943. According to this commentator, a substantial economic presence standard "incorporates due process 'purposeful direction' towards a state while examining the degree to which a company has exploited a local market." *Id.* Further, "[a] substantial economic presence analysis involves an examination of both the quality and quantity of the company's economic presence." *Id.,* 49 Tax Law. at 944. Finally, under this test, "[p]urposeful direction towards a state is analyzed as it is for Due Process Clause purposes," and the Commerce Clause analysis requires the additional examination of "the frequency, quantity and systematic nature of a taxpayer's economic contacts with a state." *Id.,* 49 Tax Law. at 945. We find this rationale persuasive and will apply it in determining the constitutionality of the taxes at issue.

First, however, we must address several objections proffered by MBNA to the application of any standard other than physical presence. Initially, MBNA contends that a greater nexus requirement should be applied to the imposition of direct taxes such as those at issue because such taxes are actu-

ally more burdensome. This is because sales and use taxes merely require an entity to collect the tax from consumers and remit the tax money to the government, thus suffering the administrative complications and inconvenience but not the cost of the tax. In sharp contrast, says MBNA, franchise and income taxes not only have compliance burdens but also must be paid from the entity's own pocket. For support, MBNA cites *National Geographic Society v. California Bd. of Equalization,* 430 U.S. 551, 97 S.Ct. 1386, 51 L.Ed.2d 631 (1977), in which the Supreme Court distinguished between a use tax and a direct tax and implied that a higher Commerce Clause standard would be required to support the imposition of a direct tax.[16]

We do not agree with MBNA's argument on this issue. Notably, the Supreme Court's comment in *National Geographic Society* was dicta in that it was not necessary to the decision in that case. In contrast, the *Bellas Hess* and *Quill* Courts placed significant weight on the fact that there are substantial compliance burdens attached to the collection of sales and use taxes. Therefore, we reject MBNA's claim that the imposition of direct taxes is a greater burden than the duty to collect taxes so that the *Bellas Hess/Quill* physical-

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[16] Specifically, the Court in *National Geographic Society* reasoned that,

> The case for the validity of the imposition upon the out-of-state seller enjoying such services of a duty to collect a use tax is even stronger. The out- of-state seller runs no risk of double taxation. The consumer's identification as a resident of the taxing State is self-evident. The out-of-state seller becomes liable for the tax only by failing or refusing to collect the tax from that resident consumer. Thus, the sole burden imposed upon the out-of-state seller by statutes [imposing a use tax] is the administrative one of collecting it.

430 U.S. at 558, 97 S.Ct. at 1391 (citations omitted).

presence test should also apply to the imposition of the direct taxes at issue.[17]

MBNA also argues that adoption of any substantial nexus requirement short of showing actual physical presence is in fact simply applying a Due Process minimum contacts standard in violation of *Quill* which expressly held that the Due Process and Commerce Clause analyses are separate. We disagree. The Due Process Clause requires merely some minimum connection between a state and the person, property or transaction it seeks to tax. In contrast, a substantial nexus under the Commerce Clause requires that an entity's contacts with the taxing state be more frequent and systematic in nature. Additionally, an entity's exploitation of the market must be greater in degree than under the Due Process standard so that its economic presence can be characterized as significant or substantial. In sum, although a substantial economic presence standard is by nature more elastic than the bright-line physical presence test, we are convinced that when properly applied, a greater nexus is required under the substantial economic presence standard that under the minimum contacts analysis.

Finally, MBNA avers that the only case from a foreign jurisdiction that is factually on point with the instant case is *J.C. Penney Nat'l Bank v. Johnson,* 19 S.W.3d 831 (Tenn.Ct.App. 1999), in which the Tennessee appellate court

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[17] MBNA notes that in *Western Maryland Ry. Co. v. Goodwin,* 167 W.Va. 804, 826, n. 3, 282 S.E.2d 240, 253 n. 3 (1981), this Court quoted with approval a party's brief for the proposition that "the form of the tax is irrelevant to the due process questions of nexus and state benefits." This statement does not inform our present analysis for several reasons. First, it is dicta. Second, it was prior to the Supreme Court's bifurcation of Due Process and Commerce Clause analyses. Finally, it was prior to the distinction made by the *Quill* Court between the test to be used in determining the constitutionality of sales and use taxes versus other types of state taxes.

applied the physical- presence test to Tennessee's attempted imposition of income taxes on an out-of-state credit card company. While we acknowledge that *J.C. Penney* is factually on point and addresses the same issue as the one before us, for the reasons set forth above we reject the reasoning in *J.C. Penney*, and decline to apply it to the instant case.[18]

We now turn our attention to the facts of the instant case to determine whether MBNA had a substantial nexus with this State during the time period in question. The record shows that MBNA continuously and systematically engaged in direct mail and telephone solicitation and promotion in West Virginia. Further, in tax year 1998, MBNA had significant gross receipts attributable to West Virginia customers in the amount of $8,419,431.00, and in tax year 1999, MBNA had significant gross receipts attributable to its West Virginia customers in the amount of $10,163,788.00. In light of these facts, this Court has no trouble concluding that MBNA's systematic and continuous business activity in this State produced significant gross receipts attributable to its West Virginia customers which indicate a significant economic presence sufficient to meet the substantial nexus prong of *Complete Auto*.[19]

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[18] MBNA also argues that physical presence has been a base-line fact in every tax nexus case decided by the Supreme Court since *Complete Auto*. In other words, says MBNA, the Supreme Court has never upheld a finding of nexus in any case involving a state tax where the putative taxpayer had no in-state presence. It is equally true, however, as noted by the Commissioner, that no Supreme Court decision has applied the *Bellas Hess* physical presence requirement to a state income tax. Thus, we are not persuaded by MBNA's argument.

[19] MBNA also asserts that the circuit court confused the first prong of the *Complete Auto* test with the fourth prong in determining the validity of the taxes at issue. We need not decide this issue because this Court's analysis is based entirely on the "substantial nexus" prong of *Complete Auto*. It is axiomatic that "[t]his Court may, on appeal, affirm the judgment of the lower court when it appears that such judgment is

Finally, prior to concluding, we simply wish to acknowledge the great challenge in applying the Commerce Clause to the ever-evolving practices of the marketplace. James Madison, Benjamin Franklin, and the other Framers at the Constitutional Convention who adopted the Commerce Clause lived in a world that is impossible for people living today to imagine. The Framers' concept of commerce consisted of goods transported in horse-drawn, wooden-wheeled wagons or ships with sails. They lived in a world with no electricity, no indoor plumbing, no automobiles, no paved roads, no airplanes, no telephones, no televisions, no computers, no plastic credit cards, no recorded music, and no iPods. Likewise, it would have been impossible for the Framers to imagine our world. When they fashioned the Commerce Clause, they could not possibly have foreseen the complex and varied ways that commerce is conducted today, especially via the internet and electronic commerce. It would be nonsense to suggest that they could foresee or fathom a time in which a person's telephone call to his or her local credit card company would be routinely answered by a person in Bombay, India, or that a consumer could purchase virtually any product on a computer with the click of a mouse without leaving home. This recognition of the staggering evolution in commerce from the Framers' time up through today suggests to this Court that in applying the Commerce Clause we must eschew rigid and mechanical legal formulas in favor of a fresh application of Commerce Clause principles tempered with healthy doses of fairness and common sense. This is what we have attempted to do herein.

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correct on any legal ground disclosed by the record, regardless of the ground, reason or theory assigned by the lower court as the basis for its judgment." Syllabus Point 3, *Barnett v. Wolfolk*, 149 W.Va. 246, 140 S.E.2d 466 (1965).

IV.

CONCLUSION

In conclusion, for the reasons set forth above, we affirm the June 27, 2005, order of the Circuit Court of Kanawha County and conclude that West Virginia's imposition of its business franchise and corporation net income taxes on MBNA for the tax years 1998 and 1999, did not violate the Commerce Clause.

Affirmed.

Davis, C.J., concurring:

In this case, MBNA, an out-of-state credit card company disputed the imposition of business franchise and corporation net income taxes on its profits[1] generated from West Virginia residents in the years 1998 and 1999. The majority opinion, applying sound legal analysis, determined that the application of the taxes did not violate the Commerce Clause because MBNA's business activity in this State constituted a significant economic presence sufficient to meet the substantial nexus standard. I fully concur in the majority decision and its analysis. I have chosen to write separately to emphasize the correctness of the legal analysis articulated in the majority decision and, further, to respond to several misconceptions contained in the dissenting opinion.

In the lone dissenting opinion, my colleague chastises the majority and states that "[t]here is no precedential support whatsoever for the conclusions reached by the majority decision. None. None at the state level. None at the federal

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[1] In 1998, MBNA had gross profits of $8,419,431.00 from its West Virginia customers. In 1999, the gross profits were $10,163,788.00. *See* Majority opinion, p. 2 [App. 3a].

level." *See* Dissenting opinion, pgs 1-2 [App. 28a]. The critical point that the dissent fails to acknowledge is that there is no established precedent, either way, from the United States Supreme Court. The sole decision on this topic is from the Tennessee Court of Appeals. *See generally J.C. Penney Nat'l Bank v. Johnson*, 19 S.W.3d 831 (Tenn. Ct. App. 1999). It has long been held that "[i]n considering and deciding the constitutionality of a tax imposed and collected by this state, in the light of a provision of the Constitution of the United States, this Court is bound by applicable decisions of the Supreme Court of the United States[.]" Syl. pt. 2, in part, *State ex rel Battle v. B.D. Bailey & Sons, Inc.*, 150 W. Va. 37, 146 S.E.2d 686 (1965). However, no such requirement exists as to decisions rendered by other state courts. Moreover, it is expressly left to each state to regulate commerce inside its borders, within the confines of constitutional directives.

The majority opinion performed a critical analysis of the United States Supreme Court decision in *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S. Ct. 1904, 119 L. Ed.2d 91 (1992). The *Quill* opinion considered the Commerce Clause in connection with use and sale taxes, not the types of taxes at issue in the present case. Therefore, while the *Quill* opinion is instructive, it is not exactly on point with the case *sub judice*. The majority opinion succinctly interpreted the *Quill* decision, which determined that a physical presence was needed prior to imposing in-state sales taxes on an out-of-state mail-order house under the Commerce Clause. In its analysis, the majority of this Court correctly observed that physical presence is not a requirement of the substantial nexus standard with regard to the taxes at issue herein. Taking into account the realism of today's world, the majority astutely recognized that *Quill's* physical presence requirement for showing a substantial nexus under the Commerce Clause applies only to use and sales taxes and not to business franchise and corporation net income taxes, which are the taxes at issue in the present case. Such an interpretation was

invited by the *Quill* Court when it noted that it has not adopted a bright line, physical presence requirement in any area except sales and use taxes. *See* Majority opinion, p. 14 [App. 13a-14a]. In its interpretation of *Quill*, the majority opinion correctly recognized the legal differences between the Due Process Clause and the Commerce Clause, as well as the even finer distinctions between the application of sales and use taxes as opposed to business franchise and corporation net income taxes. The majority opinion articulates and appreciates these distinctions; the dissenting opinion does not.

Further, the dissenting opinion, in its discussion regarding the physical presence component of the substantial nexus prong, strays from the issue before this Court by discussing at length the minimum contacts required under the Due Process Clause. In so doing, the dissenting opinion accuses the majority of merging Due Process and Commerce Clause nexus requirements. However, the majority opinion correctly addresses this argument, which was first raised by MBNA, by recognizing the contact requirements under both doctrines. The majority opinion concludes that "although a substantial economic presence standard is by nature more elastic than the bright-line physical presence test, we are convinced that when properly applied, a greater nexus is required under the substantial economic presence standard [than] under the minimum contacts analysis." *See* Majority opinion, pgs. 21-22 [App. 20a].

Moreover, the dissenting opinion's lengthy discussion of the Due Process Clause is unwarranted and prone to create confusion. The application of the Due Process Clause is not the issue presented for resolution in this case nor does it play any role in the decision reached by the majority of the Court. The question that was brought for our review was, solely, "whether application of West Virginia's business franchise and corporation net income taxes to MBNA, a business with

no physical presence in this state, violates the Commerce Clause of the United States Constitution." Majority opinion, p. 5 (footnote omitted) [App. 5a]. Significantly, as recognized by the majority opinion, the requirements for satisfying the Due Process Clause and the Commerce Clause are different. *See* Majority opinion, p. 10 ("In addressing this issue, the Supreme Court first indicated that in determining the propriety of a state use tax on an out-of-state corporation 'the nexus requirements of the Due Process and Commerce Clauses are not identical.'" (internal citation omitted)) [App. 10a]. The Due Process Clause is concerned with notions of fairness, while the Commerce Clause is aimed at the effects of state regulation on the national economy. Thus, the dissenter's analysis under the Due Process Clause is wholly irrelevant and inapplicable to the issue before the Court in this case.

The final point I wish to address is the dissent's unexplained and rigid adherence to a physical presence requirement for all types of taxes. The dissenting opinion argues that the taxing scheme at issue impermissibly burdens interstate commerce, yet it fails to explain how such an impermissible scheme occurs. *See* Syl. pt. 3, *Battle*, 150 W. Va. 37, 146 S.E.2d 686 ("A tax imposed pursuant to an act of the legislature of this state will not be held to contravene the commerce clause of Article I, Section 8 of the Constitution of the United States unless the imposition of the tax discriminates against or imposes an undue burden on interstate commerce. Such a tax will not be held to violate the commerce clause merely because it relates to or affects interstate commerce in some indirect, incidental and inconsequential manner."). When a company, whether out-of-state or in-state, earns millions of dollars[2] directly as a result of its dealings with West Virginia customers, should it not be com-

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[2] *See* note 1, *supra*.

pelled to pay taxes?[3] If not, then all companies would only deal with out-of-state customers so as to avoid all business franchise and corporation net income taxes. Such a result is perverse, especially when considering the climate of today's business world where new technology has made it possible for businesses to span the globe. I see no reason why a small "mom and pop" store in the State of West Virginia, with gross receipts in the thousands, should be compelled to pay business franchise and corporation net income taxes due to its physical presence in the State, while a large corporation, like MBNA, who makes millions of dollars from West Virginia's economy, would be exempt from such taxes simply because it has no physical presence here. As the majority shrewdly points out, in today's world, a business does not necessarily need a physical presence anywhere. MBNA's significant economic presence in this State meets the substantial nexus standard; thus, it should not be exempt from state taxation.

Because the majority correctly addressed and resolved the issues in this case, I respectfully concur with the opinion of the Court.

Benjamin, Justice, dissenting:

In its opinion finding tax liability for an out-of-state corporation with no presence, tangible or intangible,[4] in West

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[3] On its multimillion dollar gross profits, *see* note 1, *supra*, MBNA was required to pay, in 1998, a business franchise tax of $32,010.00 and a corporation net income tax of $168,034.00. In 1999, MBNA was required to pay a business franchise tax of $42,339.00 and a corporation net income tax of $220,897.00. *See* Majority opinion, p. 2 [App. 3a].

[4] See Majority Opinion, page 1 (". . . MBNA has no real or tangible personal property . . . in West Virginia.") [App. 2a] and Note 11, page 12 (In the instant case, there is no claim that MBNA has intangibles in West

Virginia on income realized out-of-state by that corporation from accounts kept out-of-state, the majority, in its opinion, boldly goes where no court has gone before. In doing so, the majority relies not on bedrock constitutional principles or on established legal precedent, but rather on legal commentaries with thinly veiled state-favoring taxing agendas, a strained and inaccurate reading of the United States Supreme Court's decision in *Quill Corp. v. North Dakota*, 504 U.S. 298,112 S.Ct. 1904, 111 L.Ed.2d 91 (1992), and a unilateral restatement of the important policy considerations which led to the inclusion of the Commerce Clause within the United States Constitution because, according to the majority opinion, the framers could not possibly have foreseen the future. The majority opinion gives legal sanction to a state taxing scheme which impermissibly burdens the interstate commerce of the nation. I therefore dissent.

There is no precedential support whatsoever for the conclusions reached by the majority decision. None. None at the state level. None at the federal level. Ignoring that our consideration here should be the effect of the tax in question on interstate commerce, rather than the type of tax it is, none of the rhetoric raised by the majority opinion explains why a state's imposition of a tax on an out-of-state corporation with no presence, tangible or intangible, on income realized from an out-of-state account does not adversely affect the nation's interstate commerce, an analysis identified by the United States Supreme Court as the cornerstone of constitutional jurisprudence. *Id.*; *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768, 112 S.Ct. 2251, 119 L.Ed.2d 533 (1992). The only state court decision on point with the specific credit card issues raised herein determined that the the State of Tennessee exceeded its taxing jurisdiction in at-

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Virginia that provide a sufficient nexus for tax purposes.") [App. 11a-12a].

tempting to collect taxes from an out- of-state corporation on income generated by out-of-state credit accounts. *J.C. Penney National Bank v. Johnson*, 19 S.W.3d 831 (Tenn. Ct. App. 1999), *cert. denied*, 531 U.S. 927, 121 S.Ct. 305, 148 L.Ed.2d 245 (2005).

State taxation of companies engaged in interstate commerce must comport with the Due Process and Commerce Clauses of the United States Constitution. In *Quill*, the United States Supreme Court emphasized that separate constitutional analyses are required in evaluating the validity of state taxes under each provision. *Quill*, 504 U.S. at 305 ("The two constitutional requirements differ fundamentally [and] reflect different constitutional concerns."). Though both the Due Process Clause and the Commerce Clause require an out- of-state taxpayer to have established a meaningful nexus with a given state to be the proper subject of taxation of that state, imposition of a tax on an out-of-state taxpayer may meet the less stringent nexus requirements of the Due Process Clause, yet fail to meet the more substantial nexus requirements of the Commerce Clause. *Id.* ("[W]hile a State may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the Commerce Clause.").

Among the most fundamental precepts of state taxation from a Commerce Clause perspective is that there must be a "substantial nexus" between the interstate activity sought to be taxed and the taxing State. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977). Under *Complete Auto*, a state tax is permitted under the Commerce Clause if it (1) is applied to an activity with a substantial nexus with the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by

the state. 430 U.S. at 279.[5] While I agree with my colleagues that the "substantial nexus" prong of this test is ripe for clarification by the United States Supreme Court, I disagree with them to the extent that the majority opinion finds insufficient guidance in the existing jurisprudence of the United States Supreme Court to conclude that the State's present attempt to levy a tax on income realized outside the State by an out-of-state corporation with no presence, tangible or intangible, in the State violates the Commerce Clause.

Three years after deciding *Complete Auto*, the Supreme Court noted in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 100 S.Ct. 1223, 63 L.Ed.2d 510 (1980), that for an application of state tax jurisdiction to be constitutional under the Due Process Clause, there must be: (1) nexus or some *minimal* connection between the taxing state and the activity from which the income is derived; and (2) a rational relationship between the income attributed to the taxing state and the interstate values of the enterprise. 445 U.S. at 436-7. These constitutional requirements were subsequently confirmed in *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 108 S.Ct. 1619, 100 L.Ed.2d 21 (1988), *Allied-Signal*, and *Quill*.

Reading *Complete Auto* and *Mobil Oil* together, one discerns two aspects to the consideration of nexus. First, there must be an adequate connection between the taxing state and the out-of-state corporation upon which a tax is being assessed; *i.e.*, a "presence" consideration. Second, there must also be an adequate connection between the taxing state and

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[5] There is often overlap in the consideration of these four requirements. The "substantial nexus" requirement is said to protect against undue burdens on interstate commerce while fair apportionment is understood to guard against taxes which have the effect of "pass[ing] an unfair share of the tax burden onto interstate commerce." *Quill*, 504 U.S. at 313. In practical effect, the exercise of multiple taxation by several states under the apportionment standard may lead to apportionment issues which likewise should be considered under the "substantial nexus" standard.

the event which gives rise to the claimed tax; *i.e.*, a "transaction" consideration.

Prior to the United States Supreme Court's decisions in *Allied-Signal* and *Quill*, some argued for a merging of the Due Process and Commerce Clause nexus considerations through application of a so-called "economic exploitation" nexus consideration. *Quill* establishes that, for Commerce Clause purposes, a higher presence nexus is required than the minimal nexus connection required for Due Process purposes. In other words, a corporation's "presence" may suffice for taxing jurisdiction under the minimal Due Process nexus test, but fail to meet the "substantial" higher presence nexus test required by the Commerce Clause.

We must assume that the United States Supreme Court chose its words carefully in setting forth the first prong of the *Complete Auto* test, that the tax in question is sought by the taxing state to be applied "to an activity" with a substantial nexus with the taxing state. Even if the majority opinion was correct, which I believe it was not, that MBNA's interstate activities constitute a sufficiently high showing of presence to permit taxing jurisdiction under the "substantial" nexus test of the Commerce Clause, the majority opinion simply reaches the question of whether the State of West Virginia may seek to tax MBNA as an out-of-state corporation. The majority opinion completely fails to consider the effect of the tax on interstate commerce. On this second question of whether a state can impose tax on income generated out-of-state, the majority opinion likewise fails. Here, there is no question but that the credit card accounts which give rise to MBNA's income are located outside West Virginia.

I must admit to being intrigued by the majority opinion's description of its nexus requirement as a "significant economic presence test" as much for its vagueness as for its embodiment as the antithesis of the "bright line" standards set forth by the United States Supreme Court in *Quill* and *Na-*

tional Bellas Hess v. Department of Revenue of Illinois, 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967), *overruled, in part, by Quill*. The reality is that by endorsing a nexus standard which permits West Virginia to assess a tax on an out-of- state corporation with no property, tangible or intangible, in this state on income realized from credit accounts maintained and serviced in another state, the majority merges the nexus requirements of the Due Process Clause and the Commerce Clause and effectively returns to the merged nexus jurisprudence of 1967, in *Bellas Hess*, albeit with the minimal due process requirements now carrying the day for nexus determination rather that the physical presence requirement of *Bellas Hess*. While MBNA may meet the minimal nexus requirement for it to be on notice from a due process basis that it may be subject to taxation, the majority opinion fails to show how the out-of-state credit account, which is the basis for the income sought to be taxed, meets the substantial nexus requirements of *Complete Auto* and *Quill*. Indeed, one might seriously question the due process basis for West Virginia's attempted actions herein.[6]

The majority opinion attempts mightily to distinguish between forms of taxes, such as sales and use taxes on the one hand, and income and franchise taxes on the other hand, in attempting to defend its disregard for the substantial nexus standards required in *Quill*. The majority's argument appears to be that because the instant case concerns the taxation of income realized by an out-of-state corporation from accounts

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[6] One might well argue that the State of West Virginia, under the facts of this case, is attempting to engage in extraterritorial taxation. "Under both the Due Process and the Commerce Clauses of the Constitution, a State may not, when imposing an income-based tax, 'tax value earned outside its borders.'" *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 164, 103 S.Ct. 2933, 2939, 77 L.Ed.2d 545, 552 (1983) (quoting *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315, 102 S.Ct.3103, 3108, 73 L.Ed.2d 787, 794 (1982)).

in Delaware and because *Quill* instead involved use and sales taxes from purchases made by purchasers within the taxing state with delivery of goods to occur also within the taxing state, this Court is at liberty to disregard those parts of *Quill* with which it disagrees. This argument is not persuasive. In so disregarding the substantial nexus requirements of *Quill* because *Quill* involved use and sales taxes, it is interesting that the majority opinion nevertheless fully embraces the precedent of the United States Supreme Court in *Complete Auto*, a case which also involved use and sales taxes—not income taxes. Perhaps the real dichotomy here may not be between sales and income taxes, with the relevant question being when is a tax not a tax, but how the limitations set forth in the United States Constitution can be avoided to provide the State with a better opportunity to expand its taxing opportunities.

The reality is that the United States Supreme Court has not generally treated the question of state authority to tax interstate commerce as turning on the specific type of tax involved. Rather, the United States Supreme Court has focused instead on the effect of the tax which the taxing state seeks to levy on interstate commerce, regardless of the type of tax.[7] Indeed, there is no immediately clear doctrinal foundation which can be observed for distinguishing sales and use tax collection on sales between states from income taxes sought to be collected from out-of-state companies for income realized from out-of-state intangible accounts simply because the out-of-state corporation availed itself of the

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[7] In *Tyler Pipe Industries v. Washington State Department of Revenue*, 479 U.S. 1015, 107 S.Ct. 664, 93 L.Ed.2d 717 (1986), the tax in question was a business and occupation tax. The Court framed the nexus question as whether the activities performed in the taxing state on behalf of Tyler Pipe was significantly associated with Tyler Pipe's ability to establish and maintain a market for its sales. This case involved the imposition of a direct tax, similar to the income tax at issue herein.

United States mails and other forms of interstate communication.[8]

The jurisprudential reality is that the United States Supreme Court has never held in any state tax case that the nexus requirements of the Commerce Clause can be satisfied in the absence of a taxpayer's physical presence in the taxing state. The principles of *stare decisis* are no less relevant to state taxes in general, than they are to sales and use taxes particularly, when Congress has the ultimate power to prescribe the appropriate law in this area. *See*, *Quill*, 504 U.S. at 316-17. Cases decided by the United States Supreme Court both before and after *Quill* have made it clear that a substantial nexus is required for the imposition of *any* state tax on an out-of-state corporation. *See*, *Allied-Signal*, 504 U.S. at 778 ("The constitutional question in a case such as *Quill Corp.* is whether the State has the authority to tax the corporation at all."); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 626, 101 S.Ct. 2946, 69 L.Ed.2d 884 (1981) ("Under this threshold test, the interstate business must have a substantial nexus with the State before *any* tax may be levied on it.") It would be a strange constitutional doctrine that would countenance one nexus standard for sales and use taxes under the

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[8] In *Quill*, the Supreme Court while noting that it had not "in our review of other types of taxes, articulated the same physical presence requirement that *Bellas Hess* established for sales and use taxes," stated that "silence does not imply repudiation of the *Bellas Hess* rule." *Quill*, 504 U.S. at 314. In *Bellas Hess*, the Supreme Court described its decision in *Scripto, Inc. v. Carson*, 362 U.S. 207, 80 S.Ct. 619, 4 L.Ed.2d 660 (1960), a case involving a corporation physically present in the taxing state, as the Court's "furthest constitutional reach to date" of subjecting a corporation to state taxing. *Bellas Hess*, 386 U.S. at 757.

Commerce Clause, and a more relaxed nexus standard for corporate net income and other state taxes.[9]

In the first place, it does not appear that the differences between the use tax collection obligation and liability for income taxation are so significant as to justify different rules under the Commerce Clause. It is certainly difficult to see distinctions that give effect to physical presence as a necessary element for "substantial nexus" for some taxes and not for others. Arguably, the collection of use and sales taxes involves no more complexity than the determination of individual state income tax liability for a multistate corporation involved in interstate commerce where each taxing state has separate laws and seeks to maximize the definition of that which each such state contends may be taxed from out-of-state.[10] Arguably, if taxes should be treated differently under the Commerce Clause based on what the taxing state claims to tax rather than on the tax's actual impact on interstate commerce, one might well argue that something more than a

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[9] Contrary to the apparent contempt held by some for the benefits of "bright line" rules which avoid undue burdens on interstate commerce by the demarcation of a discrete realm of commercial activity that is free from interstate taxation, one might consider not only the settled expectations of taxpayers, but also the benefit to the national economy that such "bright lines" have been in the development of that economy over the last several decades. Surely interstate commerce is as worthy of protection from improper income and other taxes as it is from sales and use taxes. *See*, *Quill*, 504 U.S. at 315.

[10] Assume for the moment that a Delaware bank maintains a credit account for a customer with a Weirton, West Virginia mailing address. Assume further that that customer travels to Steubenville, Ohio and, using his credit account, makes a sizeable electronic purchase with the intent of paying for his purchase over several months. At the end of the month, the customer electronically pays a portion of his credit account balance from his place of employment using funds he has in his Pittsburgh, Pennsylvania bank account. In such a scenario, which fully involves the interstate nature of today's economy, how should the Delaware bank maintain its records for determination of income taxes?

due process minimal nexus standard should be considered for non-transactional taxes such as income taxes. Under such an argument, one might be tempted to argue that the minimum nexus standard for due process considerations in cases such as *Quill*, which involved transactions which had a tangible connection with a given state, were not intended to also apply to income taxes which a taxing state sought to apply to income generated by accounts located outside the taxing state. As this endeavor demonstrates, the same speculation which the majority employs to attempt to differentiate "substantial nexus" standards based on tax types could be alternatively applied in any number of ways not so attractive to taxing states. Absent precedential support for differentiating "substantial nexus" standards based upon tax types, this Court should resist the State's invitation for us to speculate based on semantics and, instead, focus on the effect which the state tax has on interstate commerce—here, attempting to levy an income tax on an out-of- state corporation with no property, tangible or intangible, in West Virginia where the income in question was generated from credit accounts held outside of this state.

The majority opinion also claims that a variety of changes—changes which it claims were not of a type which could be foreseen by the framers of the United States Constitution—support their extension of state tax jurisdiction into a realm considered by all others to be unconstitutional. Initially, I note some measure of foreboding anytime a court invokes the "foreseeability of the framers" as a basis for a decision—fear not because the rule of *stare decisis* is about to be followed by the court, but rather because the court is about to engage in some form of legislative activism for which the only support is political, not legal.[11] Here, the ra-

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[11] I must admit to some disdain for the rather elite nature of "foreseeability of the framers" arguments. Frequently, such invocations serve no purpose other than an attempt to excuse legislating from the bench.

tionale for the majority's "economic exploitation" nexus approach, which might more accurately be termed a "tax it if you can follow it, even if it is earned in another state" nexus approach, rings remarkably like the arguments set forth in Justice Fortas' dissent in *Bellas Hess*. In his dissent to the 1967 case, Justice Fortas advocated for an "economic exploitation nexus" test for state taxing jurisdiction. *Bellas Hess*, 386 U.S. at 761-62. Justice Fortas argued that Bellas Hess should be subject to the taxing jurisdiction of Illinois because of its "large-scale, systematic, continuous solicitation and exploitation of the Illinois consumer market." *Id.*, at 761. Furthermore, Justice Fortas argued that Bellas Hess enjoyed ". . . the benefits of, and profits from the facilities nurtured by, the State of Illinois as fully as if it were a retail store or maintained salesmen therein." *Id.*, at 762. I find it remarkable that our Court now endorses this same position—a position which the United States Supreme Court has rejected.

Yet our Court has not been the only court to embrace Justice Fortas' arguments. So too did the North Dakota Supreme Court, in its decision in *Quill*. Therein, that state supreme court, also claiming changes in society and economy, stated that ". . . within the context of contemporary society and commercial practice, we conclude that the concept of nexus encompasses more than mere physical presence within the state, and that the determination of nexus should take into consideration all connections between the out-of-state seller and the state, all benefits and opportunities provided by the State, and should stress economic realities rather than artificial benchmarks." *State by and through Heitkamp v. Quill Corp.*, 470 N.W.2d 203, 215 (N.D. 1991), *rev'd*, 504 U.S.

Other times, such invocations simply serve as the argument of last resort by courts searching for a legal basis to justify result-based decision-making. Caution should by necessity be the watchword when any court seeks to expand the power of the State on the basis of the "foreseeability of the framers" argument.

298, 112 S.Ct. 1904, 111 L.Ed.2d 91 (1992). As *Quill* demonstrates, when given the chance to again consider the "economic exploitation" nexus argument, the United States Supreme Court once again declined.

While the majority herein apparently believes, as did the North Dakota Supreme Court in *Quill*, that it may disregard the actual nexus decisions of the United States Supreme Court in favor of a theoretical nexus argument which favors the State's ability to reach out and tax income generated out-of-state by an out-of-state corporation with no presence, tangible or intangible, in West Virginia, I believe the sage reminder of Justice Scalia (joined in by Justices Kennedy and Thomas) should serve as a reminder of our duty in considering this case:

> We have recently told lower courts that "[i]f a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, [they] should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions." *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 109 S.Ct. 1917, 1921, 104 L.Ed.2d 526 (1989).

Quill, 490 U.S. at 303. We would do well to follow the precedent that is applicable herein and not attempt to anticipate an overruling by the United Supreme Court of its prior jurisprudence. The taxes in question are unconstitutional.

APPENDIX B

IN THE CIRCUIT COURT OF KANAWHA COUNTY, WEST VIRGINIA

DALE W. STEAGER, as Acting State Tax Commissioner of West Virginia, Petitioner,

v.

MBNA AMERICA BANK, N.A., Respondent.

Civil Action No. 04-AA-157

The Honorable Louis Bloom

FINAL ORDER

On June 2, 2005, counsel for both parties appeared before the Court for oral argument on the *"Acting Tax Commissioner's Petition for Appeal from Final Decision of the Office of Tax Appeals"* (hereinafter "Petition for Appeal") and the *"Cross-Petition for Appeal,"* filed by the respondent taxpayer, MBNA America Bank, N.A. After full consideration of the petitions, briefs, oral arguments, the parties' proposed findings of fact and conclusions of law, and applicable constitutional, statutory, and common law, this Court does hereby enter this Final Order, which **GRANTS** the Petition for Appeal, **REVERSES** the final decision of the Office of Tax Appeals, and **DENIES** the Cross-Petition for Appeal, based on the following findings of fact and conclusions of law.

FINDINGS OF FACT

Background

1. This matter is currently before the Court as an administrative appeal from a Final Decision of the Office of Tax Appeals and Administrative Law Judge R. Michael Reed.

2. The Acting Tax Commissioner for the State of West Virginia is appealing the Final Decision which found that

MBNA is not liable for the West Virginia Corporate Net Income Tax and the Business Franchise Tax because MBNA is not physically present in the State and the imposition of such taxes would violate the Commerce Clause of the United States Constitution.

3. MBNA is a foreign corporation domiciled outside of West Virginia. In 1998, MBNA's principal place of business and commercial domicile was Wilmington, Delaware.

4. MBNA's principal business was issuing and servicing VISA and Mastercard credit cards for customers throughout the United States, including West Virginia. *See* Stipulation of Facts and Exhibits, Number 3.

5. MBNA's business activities in West Virginia include the extension of unsecured credit to West Virginian citizens who use these credit cards at stores located in West Virginia and elsewhere. MBNA also receives income attributable to that extension of credit by receipt of payments made in West Virginia.

6. MBNA did not engage in any secured corporate or property financing. *See* Stipulation of Facts and Exhibits, Number 3.

Statutory Nexus and Presumptions

7. The nexus required for business franchise tax is found at *W.Va.Code* § 11-23-5a(d):

> Engaging in business-nexus presumptions and exclusions. A financial organization that has its commercial domicile in another state is presumed to be regularly engaging in business in this state if during any year it obtains or solicits business with twenty or more persons within this state, or if the sum of the value of its gross receipts attributable to sources in this state equals or exceeds one hundred thousand dollars[.]

8. The nexus required for corporate net income tax is found at *W.Va.Code* § 11-24-7b(d):

> Engaging in business-nexus presumptions and exclusions. A financial organization that has its commercial domicile in another state is presumed to be regularly engaging in business in this state if during any year it obtains or solicits business with twenty or more persons within this state, or if the sum of the value of its gross receipts attributable to sources in this state equals or exceeds one hundred thousand dollars[.]

9. In tax year 1998, MBNA's gross receipts attributable to a West Virginia source amounted to Eight Million, Four Hundred Nineteen Thousand and Four Hundred Thirty One Dollars ($8,419,431.00). This is more than eighty times the statutory threshold for nexus for the imposition of corporate net income and business franchise taxes.

10. In tax year 1999, MBNA's gross receipts attributable to its customers with West Virginia addresses equaled, Ten Million, One Hundred Sixty Three Thousand and Seven Hundred Eighty Eight Dollars ($10,163,788.00). This is more than one hundred times the statutory threshold for nexus for the imposition of corporate net income and business franchise taxes.

Access to West Virginia Services

11. MBNA's extension of credit to West Virginia citizens is an unsecured transaction which creates the possibility that it may choose to utilize the courts of the State of West Virginia to satisfy any unsecured debt. The record reflects that MBNA, in fact, did utilize the courts of the State of West Virginia in the tax years in question and it is also beyond dispute that MBNA always had access to West Virginia's courts whether they chose to exercise that privilege or not.

See Stipulations of Facts and Exhibits Numbers 8, 9, 10, 11 and 12.

12. MBNA's benefits from West Virginia, include but are not limited to, the maintenance of a court system, education of its citizens, the establishment of its state banks and its banking and consumer protection laws as well as other services and protections provided by the State.

Cross-Petition for Appeal-Statutory Apportionment

13. MBNA's Cross-Petition for Appeal claims that if this Court overturns the Office of Tax Appeal's Final Decision and determines that MBNA is liable for the taxes in question, the Court should hold that the current statutory apportionment rules cannot be constitutionally applied to MBNA. Specifically, MBNA argues that the single-factor apportionment formula for financial organizations is unconstitutional as it is not fairly apportioned to MBNA's activities in West Virginia.

14. MBNA has stipulated that it is a financial organization for purposes of the West Virginia taxes in question.

15. When the West Virginia Legislature enacted both the corporate net income and business franchise tax it chose a different apportionment formula for financial organizations than corporations and partnerships because the legislature found that financial organizations had particular characteristics which made the general apportionment formula for corporations and partnerships inappropriate.

16. *West Virginia Code* section 11-23-5a(f) and *West Virginia Code* Section 11-24-7b(g), share common language regarding the calculation of the Special Gross Receipts factor which apportions income to West Virginia. In pertinent part, the statutes provide that the gross receipts factor is a *fraction,* the numerator of which is the total gross receipts of the taxpayer from sources within this state during the taxable

year and the denominator of which is the total gross receipts of the taxpayer wherever earned during the taxable year.

17. To avoid paying taxes to this jurisdiction, MBNA challenges the West Virginia apportionment formula on constitutional grounds as it claims that the formula is not fairly apportioned.

STANDARD OF REVIEW AND APPLICABLE LAW

Standard of Review

1. This case presents pure questions of law which are subject to *de novo* review. *See Verizon West Virginia, Inc. v. West Virginia Employment Programs Workers Compensation Div.*, 214 W.Va. 95, 586 S.E.2d. 170 (2003).

Constitutional Law

2. To determine whether a state tax violates the federal Commerce Clause, courts apply the four factor test set out in *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977). The test indicates that a tax does not violate the Commerce Clause if it:

> (1) is applied to an interstate activity with a substantial nexus to the taxing state;
>
> (2) is fairly apportioned;
>
> (3) does not discriminate against interstate commerce; and
>
> (4) is fairly related to the services provided by the taxing state.

3. In *Commonwealth Edison Co. v. Montana,* 453 U.S. 609, 623-24 (1981) the Supreme Court stated the following with regard to the interplay between prong one and prong four of the *Complete Auto* test:

> The relevant inquiry under the fourth prong of the *Complete Auto Transit* test is not as appellants sug-

> gest, the *amount* of the tax of the *value* of the benefits allegedly bestowed as measured by the costs the State incurs on account of the taxpayer's activities. *Rather, the test is* closely connected to the first prong of the Complete Auto Transit test. Under this threshold test, the interstate business must have a substantial nexus with the State before any tax may be levied on it. See *National Bellas Hess, Inc. v. Illinois Revenue Dept.*, 386 U.S. 753, 97 S.Ct. 1389, 18 L.Ed.2d 505 (1967) (emphasis added.).

4. In *Quill Corp. V. North Dakota,* 504 U.S. 298, 313 (1992), the Supreme Court stated the following with regard to the first and the fourth prong of the Complete Auto Transit test:

> The first and fourth prongs, which require a substantial nexus and a relationship between the tax and state-provided services, limit the reach of state taxing authority so as to ensure that state taxation does not unduly burden interstate commerce. Thus, the "substantial nexus" requirement is not, like due process' "minimum contacts" requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce.

5. The *Quill* Court acknowledged that its Commerce Clause jurisprudence following the decision in *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753 (1967) now favors a more flexible balancing analyses; however, the Court adhered to the "bright-line physical presence test" which it articulated in *Bellas Hess* for evaluation of nexus for sales and use tax.

6. In *Hartley Marine Corp. v. Mierke,* 196 W.Va. 669 (1996), the Supreme Court stated:

> Taxes are not paid to the state on a quid pro quo basis. It is sufficient for the fairly related test that a tax-

> payer receives the customary services provided by a state in response to the expectations and demands of a civilized society, such as fire and police protection, opportunities to seek emergency hospital care, food and fuel sources, a trained work force and judicial access. As we explained in *Western Maryland,* all of these state provided services and benefits, whether utilized or not, "contribute to the viability of ... [Appellants] operations overall."

Hartley, 196 W.Va. at 680, (citations omitted) (emphasis added).

Apportionment

7. For business franchise tax, the plain language of the apportionment statute applicable to financial organizations, states in pertinent part:

> (a) *General.*-The Legislature hereby finds that the general formula set forth in section five of this article for apportioning the tax base of corporations and partnerships taxable in this state as well as in another state is inappropriate for use by financial organizations due to the particular characteristics of those organizations and the manner in which their business is conducted. *Accordingly, the general formula set forth in section five of this article may not be used to apportion the tax base of such financial organizations which shall use only the apportionment formula and methods set forth in this section.*

W. Va.Code § 11-23-5a(a)(*emphasis added.*)

8. West Virginia's apportionment formula states as follows:

> (f) *Special gross receipts factor.* - The gross receipts factor is a fraction, the numerator of which is the total gross receipts of the taxpayer from sources within this state during the taxable year and the denominator

of which is the total gross receipts of the taxpayer wherever earned during the taxable year: Provided, that neither the numerator nor the denominator of the gross receipts factor shall include receipts from obligations described in paragraphs (A), (B), (C) and (D), subdivision (l), subsection (f), section six, article twenty-four of this chapter. (l) Numerator. - The numerator of the gross receipts factor shall include, in addition to items otherwise includable in the sales factor under section five of this article, the following:

(F) Interest income and other receipts, including service charges, from financial institution credit card and travel and entertainment credit card receivables and credit card holders' fees if the borrower or debtor is a resident of this state or if the billings for any such receipts are regularly sent to an address in this state;

(G) Merchant discount income derived from financial institution credit card holder transactions with a merchant located in this state. In the case of merchants located within and without this state, only receipts from merchant discounts attributable to sales made from locations within this state shall be attributed to this state. It shall be presumed, subject to rebuttal, that the location of a merchant is the address shown on the invoice submitted by the merchant to the taxpayer;

W.Va.Code, § 11-23-5a.

9. The same plain language regarding legislative intent can be found in the statute regarding corporate net income tax for financial organizations:

(a) *General.*-The Legislature hereby finds that the general formula set forth in section seven of this article for apportioning the business income of corporations taxable in this state as well as in another state is

> inappropriate for use by financial organizations due to the particular characteristics of those organizations and the manner in which their business is conducted. *Accordingly, the general formula set forth in section seven of this article may not be used to apportion the business income of such financial organizations, which shall use only the apportionment formula and methods set forth in this section.*

W. Va.Code § 11-24-7b(a)(*emphasis added.*)

10. In 1978, the United States Supreme Court stated:

> The Due Process Clause places two restrictions on a State's power to tax income generated by the activities of an interstate business. First, no tax may be imposed, unless there is some minimal connection between those activities and the taxing[.]
>
> Second, the income attributed to the State for tax purposes must be rationally related to "values connected with the taxing State.

Moorman Mfg. Co. v. Bair, 437 U.S. 267, 272-273 (1978) (citations omitted)

11. In *Moorman,* the Supreme Court noted that a single-factor formula is presumptively valid. *Moorman,* 437 U.S. at 273.

12. The *Moorman* Court upheld a single factor formula used in Iowa, which represented a rough approximation of what income is attributable to the company's activities in Iowa. The Court specifically noted that Iowa's one and three factor formulas will occasionally over-reflect or under-reflect income attributable to Iowa, but the Court found that the formula was not unfair or arbitrarily applied. *Id.* at 274-275.

CONCLUSIONS OF LAW

1. The nexus requirement set out in the statutes in question are clear and unambiguous and will be applied and not construed.

Substantial Nexus

2. MBNA's gross receipts attributable to a West Virginia source for tax years 1998 and 1999 far exceed the statutory threshold for nexus regarding the taxes in question. Therefore, it can be presumed that MBNA had a substantial nexus with the State of West Virginia for tax years 1998 and 1999.

3. No West Virginia cases which discuss the nexus required for the imposition of a tax requires that a business have a physical presence in the State to establish nexus. *See Western Maryland Railway Co. v. Goodwin,* 167 W.Va. 804, 809, 282 S.E.2d 240, 244 (1981). *See Cincinnati Milacron Company v. Hardesty,* 170 W.Va. 138, 290 S.E.2d 902 (1982).

4. The West Virginia statutes at issue do not require a business to have a physical presence in West Virginia; therefore, MBNA's lack of physical presence does not establish a lack of substantial nexus according to West Virginia law. *See* W.Va.Code § 11-23-5a(d) and W.Va.Code § 11-24-7b(d).

5. This Court finds that the "bright-line physical presence test" established in *Bellas Hess* and adhered to in *Quill* has no application in this matter because the taxes at issue here are *not* sales and use taxes.

6. There is no controlling precedent which supports MBNA's assertion that a business must have a physical presence in West Virginia in order to establish nexus for the imposition of corporate net income and business franchise taxes. *See Quill Corporation v. North Dakota* (which requires a physical presence to satisfy nexus only when the collection of a sales and use tax is at issue); *New York ex rel. Whitney v. Graves,* 299 U.S. 366 (1937), and *International*

Harvester Co. v. Wisconsin Dept. of Taxation, 322 U.S. 435 (1944).

7. Inasmuch as there is no legal requirement that MBNA must have a physical presence in West Virginia, to establish substantial nexus, this Court finds as a matter of law that MBNA's lack of a physical presence in West Virginia is not a prerequisite to finding substantial nexus to satisfy the Commerce Clause for the imposition of corporate net income and business franchise taxes.

8. This Court finds that MBNA has a substantial nexus with the State of West Virginia based on several factors. As noted, there is a presumption of a substantial nexus based on the substantial revenue that MBNA generates from West Virginia citizens. Also important is the nature of MBNA's services. It extends credit to West Virginia residents, who provide payment to MBNA, from West Virginia. Further, the Court finds that the State provides banking, and consumer credit laws as well as access to its courts which support the generation of income by MBNA.

9. The Court finds no law to support MBNA's legal argument that access to West Virginia's courts is not a benefit of civilized society or which is taken into consideration in evaluating whether the fourth prong of the *Complete Auto* test has been satisfied.

10. This Court finds that the banking, consumer credit laws, and access to the Courts enable MBNA to generate income from West Virginia customers, without the need for a physical presence in West Virginia.

11. The Court finds unpersuasive MBNA's argument that insufficient services are provided and further finds that MBNA cannot accurately describe the value of its access to the courts based upon its business decisions relating to the use of the courts in the tax years in question. Simply put, this Court finds that access to West Virginia courts is of a great

benefit to MBNA because it admittedly extends substantial credit to West Virginians which extension of credit is unsecured and thus it is obvious that access to West Virginia courts is essential to MBNA's business operations.

12. The Court finds that the taxes in question are appropriate because they are fairly apportioned to MBNA's activities in West Virginia.

13. The payment of fairly apportioned taxes to a jurisdiction where substantial nexus is established does not constitute a undue burden on interstate commerce. The Court concludes that the taxes in question do not constitute an undue burden on interstate commerce.

14. MBNA receives substantial benefits from West Virginia and the Court concludes that the taxes in question are fairly related to the services MBNA receives from the State of West Virginia.

15. The Court finds no violation of the Commerce Clause of the United States Constitution.

16. The Court finds that the corporate net income and business franchise taxes have been correctly applied to MBNA.

Apportionment

17. The West Virginia Legislature chose to apportion income earned by financial organizations differently than income earned by corporations and partnerships. There has been no argument or showing that the Legislature lacked a rational basis to draw such a distinction.

18. MBNA has made no showing that it is treated differently than other financial organizations including financial organizations domiciled in West Virginia.

19. West Virginia's use of a single factor sales formula, which apportions a fraction of a financial organization's

gross receipts attributable to a West Virginia source, is constitutional.

20. West Virginia's apportionment formula is constitutional because if every state taxed, as West Virginia does, a portion of a company's gross receipts, based on a statement sent to the taxing state, there would be no duplicative taxation.

21. West Virginia's apportionment statute is fairly related to its income derived from West Virginia residents because the gross receipts from bills sent to West Virginia are used as part of the fraction for determining the tax to be paid. The gross receipts attributable to West Virginia are divided by its nationwide receipts before the tax rate is applied. Therefore, West Virginia taxes only its fair share of MBNA's gross receipts.

22. The rate of tax for West Virginia financial organizations is the same as the rate for MBNA, thus, there is no discrimination.

23. Thus, this Court finds that MBNA was rightfully assessed corporate net income and business franchise tax by the State of West Virginia because its activities in the State generates income far in excess of what is required to establish nexus in the State which generation of income is supported by services provided by the State.

24. The Court concludes that MBNA must pay the corporate net income and business franchise taxes for the tax years in question and that the administrative order eliminating MBNA's tax liability for the years in question is reversed. Therefore the Court concludes that the refunds of $32,010.00 and $168,034.00 for tax year 1998 and $42,339.00 and $220,897.00 for tax year 1999 are voided.

Accordingly, the Final Decision of the Office of Tax Appeals and ALJ Reed is **REVERSED**. The Court does hereby **ORDER** that the refunds in question are **VOIDED**.

The Court notes the objections of any party to the entry of this Order.

The Clerk is **DIRECTED** to send a certified copy of this Order to all counsel of record and to the West Virginia Office of Tax Appeals.

There being nothing further, the Clerk is **DIRECTED** to remove this action from the Court's active docket.

ENTERED: This 27th day of June, 2005

The Honorable Louis H. Bloom

13th Judicial Circuit Court

State of West Virginia

APPENDIX C

REDACTED SANITIZED DECS. 03-185 RN, 03-186 RFN, 04-074 RFN & 04-075 RN – BY R. MICHAEL REED – SUBMITTED FOR DECISION ON 04-27-04 – ISSUED ON 10-22-04*

FINAL DECISION

PROCEDURAL BACKGROUND

On September, 2002 [sic], the Petitioner timely filed *claims* for refunds (amended tax returns setting forth the refund claims) of West Virginia business franchise tax and of West Virginia corporate net income tax, for the calendar and tax year 1998.

By letters received by the Petitioner in December, 2002, the Corporate and Franchise Tax Unit ("Unit") of the Internal Auditing Division of the West Virginia State Tax Commissioner's Office ("the Commissioner" or the "Respondent") denied each of these tax refund claims for the year 1998. The reason stated for the total denial of these refund claims was that the Petitioner, for this year, met the statutory test for, presumptively, "regularly engaging in business" in the State of West Virginia, by virtue of the Petitioner's West Virginia gross receipts for that year of $. *See* W. Va. Code §§ 11-23-5a(d) [1996] (West Virginia business franchise tax) and 11-24-7b(d) [1996] (West Virginia corporate net income tax).

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* [The Office of Tax Appeals labels the opinon "redacted sanitized" because it omits the actual amounts of MBNA's West Virginia gross receipts, West Virginia gross income, and nationwide gross receipts for relevant tax years, as well as the amounts of liability at issue in certain tax collection actions in which MBNA was involved during the relevant time period. *See* App. 53a, 54a, 56a, 58a.]

Thereafter, by mail postmarked February, 2003, the Petitioner timely filed with this tribunal, the West Virginia Office of Tax Appeals, a *petition* for refund with respect to each of these two types of West Virginia state tax, for the year 1998. *See* W. Va. Code § 11-10A-8(2) [2002].

Similarly, on dates not specified in the record, the Petitioner timely filed *claims* (amended tax returns) for refunds of West Virginia business franchise tax and of West Virginia corporate net income tax, for the calendar and tax year 1999.

By letters received by the Petitioner in December, 2003, the Commissioner, by the Unit, denied each of these two tax refund claims for the year 1999, for the same reason stated in denying the refund claims for the year 1998, that is, by virtue of Petitioner's West Virginia gross receipts for the year 1999 of $. *See* W. Va. Code §§ 11-23-5a(d) [1996] (West Virginia business franchise tax) and 11-24-7b(d) [1996] (West Virginia corporate net income tax).

By mail, the Petitioner timely filed with this tribunal a *petition* for refund with respect to each of these two types of taxes, for the year 1999. *See* W. Va. Code § 11-10A-8(2) [2002].

Subsequently, notice of an evidentiary hearing on the petitions for refund was sent to the Petitioner in accordance with the provisions of W. Va. Code § 11-10A-10 [2002] and 121 C.S.R. 1, § 61.3.3 (Apr. 20, 2003). However, the parties thereafter agreed to submit the matter for decision by this tribunal on stipulated facts, memoranda of law, and oral argument. *See* 121 C.S.R. 1, § 53.1 (Apr. 20, 2003). This matter (including tax year 1999) was fully and finally submitted on April 27, 2004, for decision by this tribunal.

FINDINGS OF FACT

The material facts in this matter have been stipulated by the parties. These facts may be summarized and stated as follows.

1. The Petitioner was chartered as a national bank in the year 1991, outside of the State of West Virginia; such status applied during the two years in question here, that is, 1998 and 1999. Stipulation No. 1.

2. At all relevant times, that is, during the years 1998 and 1999, the Petitioner's principal place of business and commercial domicile was located outside of the State of West Virginia. Stipulation No. 2.

3. At all relevant times the Petitioner's principal business activity was issuing and servicing major credit cards for customers throughout the United States. Many of those credit cards were specially designated for various associations located throughout the United States that had engaged the Petitioner to provide credit cards for their members or affiliates. (The parties have not stipulated the number of West Virginia credit card customers during the relevant time period.) At all relevant times the Petitioner did not engage in any secured corporate or property financing. Stipulation No. 3.

4. The Petitioner had no office, place of business, real property, or tangible personal property located in the State of West Virginia, and the Petitioner had no employees or any other representatives who were physically present in the State of West Virginia, during the two years involved in this matter, other than the very limited and sporadic non-courtroom legal services by the in-state office of the out-of-state law firm representing the Petitioner in the three credit card debt collection actions described below in Finding of Fact No. 10. Stipulation No. 13.

5. At all relevant times the Petitioner promoted its business operations by engaging in direct mail solicitation across the country, through the United States mail, including direct mail solicitation to residents of the State of West Virginia; the Petitioner's direct mail solicitation activities were not initiated in or from West Virginia. Stipulation No. 4.

6. At all relevant times the Petitioner also promoted its business operations by engaging in telephone solicitation across the country, via long distance telephone transmissions, including telephone transmissions to residents of the State of West Virginia; the Petitioner's telephone solicitation activities were not initiated in or from West Virginia. Stipulation No. 5.

7. At various times the Petitioner "out-sourced" certain of its national marketing activities; the businesses performing such services for the Petitioner were not located in West Virginia nor sent representatives into West Virginia to perform the marketing activities. Stipulation No. 6.

8. The Petitioner did not receive or process any accounts receivable in the State of West Virginia during the time period involved in this matter. Stipulation No. 7.

9. There were three credit card debt-collection actions which had been brought on the Petitioner's behalf and which were pending during the year 1998 in unspecified magistrate courts (basically, "small claim" courts) or circuit courts (basically, general jurisdiction trial courts) of the State of West Virginia (one of these actions had been filed during that year; the other two had been filed in preceding years). The amounts involved in these debt-collection actions were, respectively, $, $, and $, plus interest. One of these debt-collection actions was dismissed with prejudice during the year 1998, due to the Petitioner's failure to prosecute the action for more than a year, for lack of records. Another of these actions was dismissed with prejudice during the year 1999, due to the Petitioner's failure to prosecute the action for more than a year, in light of the debtor's death. The third debt-collection action was dismissed with prejudice during the year 2002, due to the Petitioner's failure to prosecute the action for more than a year, in light of the debtor's personal bankruptcy. Stipulation Nos. 8-11.

10. A law firm with its main office located outside the State of West Virginia represented the Petitioner in these three credit card debt-collection actions; management of this representation occurred in and from the main office of this law firm, but an unspecified number of attorney(s) with the law firm's West Virginia office (town or county not specified), "performed some [unspecified type, frequency, and total number of hours of] work on one or more of the three [credit card debt-collection] actions [pending] in [the year] 1998"; none of the law firm's attorneys however, made any court appearances in the State of West Virginia in any of these three credit card debt-collection actions during the year 1998 (and no such court appearances occurred, apparently, during the year 1999). Supplemental Stipulation Nos. 1-3.

11. The law firm representing the Petitioner in these three credit card debt-collection actions had been retained on a contingency-fee basis; the Petitioner did not pay any attorneys' fees to this law firm for services in these three debt-collection actions because the law firm did not collect any amounts in these actions. Supplemental Stipulation No. 4.

12. In addition to the aforementioned three credit card debt-collection actions brought by the Petitioner in the courts of the State of West Virginia, the Petitioner was a defendant/counter-claimant in a civil action brought by a debtor in an unspecified circuit court in the State of West Virginia during the year 1996 for alleged unfair claim practices by the Petitioner here; this action and, apparently, the Petitioner's counterclaim were dismissed with prejudice, for unspecified reasons, during the year 1998, after, apparently, no court appearances. The record appears to indicate that no attorney with an office located in the State of West Virginia, or elsewhere, made any court appearances in this particular litigation in the State of West Virginia during the years in question. Stipulation No. 12.

13. For the year 1998, the Petitioner had gross receipts of $ attributable to customers with West Virginia addresses, including interest income, service charges, fees, and other receipts from credit cards, and $ of gross income from all other sources attributable to West Virginia. Stipulation No. 17.

14. For the year 1998, the Petitioner had a total of $ of gross receipts attributable to all sources in all states, including West Virginia. Stipulation No. 18. Thus, the ratio of Petitioner's West Virginia gross receipts to its total gross receipts for the year 1998 was 19/100 of one percent.

15. The record appears to indicate that the ratio of Petitioner's West Virginia gross receipts to its total gross receipts was within a similar range for the year 1999.

16. For the year 1998 (and, apparently, for the year 1999), the Petitioner had a property apportionment factor of zero and a payroll apportionment factor of zero for purposes of the West Virginia corporate net income tax and West Virginia business franchise tax. Stipulation of Fact No. 31.

DISCUSSION

Nexus

The only issue to be decided by this tribunal is whether the Petitioner-taxpayer has rebutted the presumption of statutory nexus in this matter. This tribunal holds in the affirmative, in light of the Federal Commerce Clause's definition, in effect, of what activity constitutes a "substantial nexus" with the taxing state, and thereby "regularly doing business" in that state.

W. Va. Code § 11-23-5a(d) [1996], for West Virginia business franchise tax purposes, and W. Va. Code § 11-24-7b(d) [1996], for West Virginia corporate net income tax purposes, provide, in relevant part:

> (d) *Engaging in business -- nexus presumptions and exclusions.* -- A financial organization that has its commercial domicile in another state is *presumed* to be regularly engaging in business in this state if during any year it obtains or solicits business with twenty or more persons within this state, or if the sum of the value of its gross receipts attributable to sources in this state equals or exceeds one hundred thousand dollars.

(italics added to the word "presumed" for emphasis). The parties in this matter agree -- and this tribunal concludes -- that the use of the word "presumed" necessarily implies that the Legislature intended that (and procedural due process would require that) each financial organization having its commercial domicile in another state is entitled to rebut the statutory presumption -- that it was regularly engaging in business in this state by virtue of having at least the minimum number of West Virginia customers or at least the minimum amount of in-state gross receipts -- by showing, from the totality of the in-state contacts, that the out-of-state financial organization was, nonetheless, not, actually, "regularly engaging in business in this state[.]"

The statutory definitions of "doing business" or "engaging in business" assist the analysis of whether a financial organization having its commercial domicile outside West Virginia, and rebuttably presumed to have sufficient nexus with this state under the statutory quantifiable factor(s), is, under *all* of the facts relevant to nexus, regularly engaging in business in this state (as a mixed question of fact and law). The business franchise tax statute generally defines the term "doing business" as meaning, in relevant part, "any activity of a corporation or partnership which enjoys the benefits and protection of the government and laws of this state[.]" W. Va. Code § 11-23-3(b)(8) [1991]. Likewise, the corporate net income tax statute defines the term "engaging in busi-

ness" or "doing business" as meaning "any activity of a corporation which enjoys the benefits and protection of [the] government and laws in this state." W. Va. Code § 11-24-3a(7) [1991].

This type of general *quid pro quo* link between the in-state activity of an out-of-state business entity and the governmental services or protection provided by the taxing state is obviously derived from federal substantive Due Process Clause precedents involving state taxation of interstate commerce. For example, the usually eloquent and insightful Justice Frankfurter stated for a 5-4 majority of the Supreme Court of the United States in *Wisconsin v. J.C. Penney Co.*, that "[a] state is free to pursue its own fiscal policies, unembarrassed by [the Due Process Clause set forth in section 1 of the Fourteenth Amendment to] the [United States] Constitution, if by the practical operation of a tax the state has exerted its power *in relation to* opportunities which it has given, to *protection* which it has *afforded*, to *benefits* which it has *conferred by* the fact of being an orderly, civilized *society*." 311 U.S. 435, 444, 61 S. Ct. 246, 249-50, 85 L. Ed. 267, 270 (1940) (emphasis by italics added).

Similarly -- but not identically -- under the federal interstate Commerce Clause, U.S. Const. art. I, § 8, cl. 3 ("The Congress shall have Power . . . To regulate Commerce . . . among the several States"), a state tax on interstate commerce is valid if "the tax [1] is applied to an *activity* with a ***substantial*** *nexus* with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is *fairly related to the services provided by the State*." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 97 S. Ct. 1076, 1079, 51 L. Ed. 2d 326, 331 (1977) (emphasis by italics and bold print added).

In *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992) (retailers' use tax collection duties), the Supreme Court of the United States held that,

"while a State may, consistent with the ['minimum connection' requirements of the] Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the ['substantial nexus' requirements of the] Commerce Clause." 504 U.S. at 305, 112 S. Ct. at 1909, 119 L. Ed. 2d at 101.

Therefore, here, as typically the case, this quasi-judicial tribunal must examine interstate Commerce Clause precedents, not merely Due Process Clause precedents, to determine if the in-state connections between an out-of-state business entity and a taxing state are constitutionally sufficient, **as applied** to all of the relevant facts, to uphold a state tax in the interstate commerce context.[1]

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[1] In cases involving state taxation of interstate commerce the actual "policy" maker (at least ultimately) under the Federal Commerce Clause is not the state legislature but the Federal Congress. However, the Supreme Court of the United States has traditionally held that it will (with increasing reluctance) establish the "policy" in the absence of Congressional action in a particular interstate commerce area ("negative" or "dormant" Commerce Clause approach), as is the case here. Accordingly, while the precedents of this state's highest court involving state taxation of interstate commerce are, of course, persuasive and will, without plenary review by the Supreme Court of the United States, become, in effect, the law in this State, this tribunal is not actually bound by the precedents of the West Virginia Supreme Court of Appeals in this area of federal law. Instead, we will look primarily to any **existing** applicable precedents of the **Supreme Court of the United States**, as that **High Court requires of us and of all other tribunals** inferior to that High Court: "If a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, the [lower tribunals] should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions." *Agostini v. Felton*, 521 U.S. 203, 237, 138 L. Ed. 2d 391, 423, 117 S. Ct. 1997, 2017 (1997). Similarly, where, as here, existing applicable precedents of the Supreme Court of the United States do exist, this quasi-judicial tribunal -- even though we, unlike general appellate courts, possess state tax expertise -- will not assume the role of a treatise author or law review commentator and decide what the policy **should** be in this area, as if we were

The "nexus presumption" statutes in this matter, for purposes of raising the rebuttable presumption of nexus for corporate net income tax and business franchise tax purposes, employ an economic-exploitation-of-the-market standard for nexus, rather than a "physical presence" nexus standard. In *Quill*, addressing sales and use taxes, the Supreme Court of the United States, in a dictum that is, frankly, vague (at the least), when put in context, stated that "we have not, in our review of other types of taxes, [explicitly] articulated the same physical-presence requirement . . . established for sales and use taxes[.]" 504 U.S. at 314, 112 S. Ct. at 1914, 119 L. Ed. 2d at 108. On the other hand, the Court at virtually the same place in *Quill* stated that "**all** of these [non- sales and use tax] cases [decided by the High Court] involved taxpayers who had a **physical** presence in the taxing State[.]" *Id.* (emphasis by bold print added), explicitly referring, for example, to two business privilege/gross income tax cases, namely, *Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue*, 483 U.S. 232, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987), and *Standard Pressed Steel Co. v. Dep't of Revenue*, 419 U.S. 560, 95 S. Ct. 706, 42 L. Ed. 2d 719 (1975). In addition, the four-prong analysis of *Complete Auto Transit* explicitly applies to a state tax, without distinguishing between types of state taxes. Finally, the "form of [the state] tax is inconsequential to questions of nexus and state benefits[.]" *Hartley Marine Corp. v. Mierke*, 196 W. Va. 669, 678 n.13, 474 S.E. 2d 599, 608 n. 13 (1996), *cert. denied*, 519 U.S. 1108, 117 S. Ct. 942, 136 L. Ed. 2d 832 (1997).[2]

Congress or the Supreme Court of the United States or as if we were writing on a blank slate.

[2] In fact, the physical presence test -- not merely an economic exploitation test -- for the Commerce Clause's "substantial nexus" requirement, which was applied, for example, in the sales and use tax **collection**-duty case of *Quill*, should apply with even more force to **direct** taxes like the corporate net income tax and the business franchise tax;

Thus, it is well settled by court precedents that under the Commerce Clause a state may not subject an activity to a tax unless the activity has a "substantial" nexus with the state, *see, e.g., Complete Auto Transit*; and that "substantial" nexus requires a finding of a physical presence in the taxing state, not merely an economic exploitation of the market, *see, e.g., Quill, Tyler Pipe, and Standard Pressed Steel; In re Intercard, Inc.*, 270 Kan. 346, 14 P.3d 1111 (2000) (collecting and analyzing United State Supreme Court and state cases, including a sound criticism of a couple of state cases relying on mere economic exploitation); *J.C. Penney Nat'l Bank v. Johnson*, 19 S.W.3d 831 (Tenn. Ct. App. 1999) (insufficient nexus for franchise and excise taxes on credit card income of nondomiciliary financial institution), *appeal denied*, (Tenn. May 8, 2000), *cert. denied*, 531 U.S. 927, 121 S. Ct. 305, 148 L. Ed. 2d 245 (2000); *Dell Catalog Sales, L.P. v. Comm'r of Revenue Services*, 48 Conn. Supp. 170, 834 A.2d 812 (Super. Ct. 2003); *Lanco, Inc. v. Dir., Div. of Taxation*, 21 N.J. Tax 200, 2003 N.J. Tax LEXIS 18 (2003); *Avco Fin. Services Consumer Disc. Co. One, Inc. v. Dir., Div. of Taxation*, 100 N.J. 27, 42-50, 494 A.2d 788, 796-801 (1985) (Clifford, J., dissenting) (excellent analysis by dissent, including emphasis on infrequent and *de minimis* use of state court system to collect loans; pre-*Quill* majority opinion applied now-outdated "minimal connection" nexus test to many more in number and more permanent in-state contacts than occurring here). *See also, e.g.*, R. Todd Ervin, Comment, *State Taxation of Financial Institutions: Will Physical Presence or Economic Presence Win the Day?*, 19

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direct taxes against a taxpayer certainly are more **financially** onerous than mere collection duties. *See, e.g.*, Thomas E. McHugh & R. Michael Reed, *The Due Process Clause and the Commerce Clause: Two New and Easy Tests for Nexus in Tax Cases*, 90 W. Va. L. Rev. 31, 37 (1987) ("shameless plug" of obviously outstanding commentary co-authored by author of this Final Decision).

Va. Tax Rev. 515, 541 (2000) ("there has been no clear [United States] Supreme Court precedent upholding a state tax challenged on Commerce Clause grounds absent some degree of physical presence by the putative taxpayer in the taxing state").

Moreover, the physical presence necessary for the Commerce Clause's "substantial nexus" requirement must be more than a "slightest presence[.]" *Quill*, 504 U.S. at 315 n. 8, 112 S. Ct. at 1914 n. 8, 119 L. Ed. 2d at 108 n. 8 (*citing Nat'l Geographic Soc'y v. Cal. Bd. of Equalization*, 430 U.S. 551, 556, 97 S. Ct. 1386, 1390, 51 L. Ed. 2d 631, 636-37 (1977). Instead, the in-state physical presence must be "'**significantly** associated with the taxpayer's ability to establish and maintain a market in'" the taxing state. *Tyler Pipe Indus. v. Wash. State Dep't of Revenue*, 483 U.S. 232, 250, 107 S. Ct. 2810, 2821, 97 L. Ed. 2d 199, 215-16 (1987) (emphasis by bold print added) (internal citation omitted). Stated another way, the in-state physical presence must have "made possible the realization and continuance of valuable contractual relations between" the taxpayer and the taxing state. *Standard Pressed Steel Co. v. Dep't of Revenue*, 419 U.S. 560, 562, 95 S. Ct. 706, 708, 42 L. Ed. 2d 719, 722 (1975). Thus, isolated and sporadic contacts are insufficient to constitute a "substantial" nexus. *See, e.g., Dell Catalog Sales, L.P. v. Comm'r of Revenue*, 48 Conn. Supp. 170, 187, 834 A.2d 812, 822 (2003); *In re Intercard, Inc.*, 270 Kan. 346, 364, 14 P.3d 1111, 1122-23 (2000); *Avco Fin. Services Consumer Disc. Co. One, Inc. v. Dir., Div. of Taxation*, 100 N.J. 27, 45, 494 A.2d 788, 798 (1985) (Clifford, J., dissenting) (insufficient nexus that one-half of one percent of total outstanding loans to taxing-state customers were collected through use of taxing-state courts).

Here, for the tax years in question, the Petitioner-taxpayer's only physical presence in West Virginia was by the extremely isolated and sporadic use of the in-state law-

yer's(s') services and courts of this state in the *de minimis* number of credit card debt-collection actions. This extremely limited type and frequency of physical presence in state -- compared with the total volume of the taxpayer's business with West Virginia customers -- constitutes a "slightest presence" and is **not** "significantly" associated with the taxpayer's ability to establish and maintain a market in this state, for the time period involved in this matter.

While application of these tests is, unfortunately, somewhat subjective in most cases (unlike the preliminarily "bright line" rule provided by the nexus presumption statutes here), this tribunal believes that the application is objectively clear (*de minimis*) in this matter. Each case must, of course, be decided on its own facts, and the frequency and type of in-state physical presence likely will vary for each time period, so that "substantial nexus" may (or may not) exist for some time periods subsequent to those involved here. This tribunal does believe that a sufficient level of debt-collection work by in-state lawyers, or a sufficient level of use of this state's courts, on behalf of a taxpayer would constitute a "substantial nexus," but the same are clearly lacking here.

Again, this tribunal is sensitive to the "policy" debate among the commentators about whether an economic-exploitation-of-the-market test should be applied under the Commerce Clause, in light of the way most modern business is done in this service-oriented, "high tech," national economy (instead of being primarily local-manufacturing-oriented); this tribunal is, however, sworn to follow existing relevant precedents of the Supreme Court of the United States, rather than anticipating a change in approach by that High Court or by Congress.[3]

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[3] The Petitioner-taxpayer in this matter also asserts that the single-factor (based upon sales only) statutory apportionment for nondomiciliary financial institutions, W. Va. Code § 11-23-5a(a) & (c) & (f)

CONCLUSIONS OF LAW

In light of the foregoing Discussion of the relevant substantive law, and in light of the relevant procedural law on the burden of proof in refund matters, it is **HELD** that:

1. Each financial organization having its commercial domicile in another state is entitled to rebut the statutory presumption -- that it was regularly engaging in business in this state by virtue of having at least the minimum number of West Virginia customers or at least the minimum amount of in-state gross receipts -- by showing, from the totality of the in-state contacts, that the out-of-state financial organization was, nonetheless, not, actually, "regularly engaging in business in this state[.]" W. Va. Code § 11-23-5a(d) [1996], for West Virginia business franchise tax purposes, and W. Va.

[1996] (business franchise tax) and W. Va. Code § 11-24-7b(a) &(c) & (f)-(g) [1996] (West Virginia corporate net income tax), violates the Commerce Clause, on the ground that the most recent relevant precedents of the Supreme Court of the United States allegedly require, in essence, the more typical three-factor (property, payroll, and sales) apportionment (such as provided by the West Virginia corporate net income tax and business franchise tax statutes for virtually all other types of businesses).

This challenge is that the apportionment statutes for nondomiciliary financial institutions is unconstitutional **on the face thereof**, not just as applied to the facts of this matter and to this taxpayer. Being a part of the executive branch of state government, this quasi-judicial tribunal, under the Separation (or "Division") of Powers Clause of the State Constitution, W. Va. Const. art. V, § 1, lacks the authority to hold that a statute is facially unconstitutional. Instead, under this state constitutional provision, this tribunal must assume the facial constitutionality of the apportionment statutes in question. It would also be inappropriate for this tribunal to offer a merely advisory opinion predicting how the Supreme Court of the United States would "reconcile" earlier and more recent precedents on this issue and decide this issue now (which issue is very interesting to this tribunal with our state tax expertise; it may be much less interesting to virtually all of the general appellate courts, but they are constitutionally given that exclusive jurisdiction).

Code § 11-24-7b(d) [1996], for West Virginia corporate net income tax purposes.

2. Under the Commerce Clause, U.S. Const. art. I, § 8, cl. 3, a state may not subject an activity to a tax unless, among three other factors, the activity has a "substantial" nexus with the taxing state. *See, e.g., Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 97 S. Ct. 1076, 1079, 51 L. Ed. 2d 326, 331 (1977).

3. A "substantial" nexus, for Commerce Clause purposes, requires a finding of a physical presence in the taxing state, not merely an economic exploitation of the market. *See, e.g., Quill Corp. v. North Dakota*, 504 U.S. 298, 314, 112 S. Ct. 1904, 1914, 119 L. Ed. 2d 91, 108 (1992); *Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue*, 483 U.S. 232, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987); *J.C. Penney Nat'l Bank v. Johnson*, 19 S.W.3d 831 (Tenn. Ct. App. 1999) (insufficient nexus for franchise and excise taxes on credit card income of nondomiciliary financial institution), *appeal denied*, (Tenn. May 8, 2000), *cert. denied*, 531 U.S. 927, 121 S. Ct. 305, 148 L. Ed. 2d 245 (2000); *In re Intercard, Inc.*, 270 Kan. 346, 14 P.3d 1111 (2000).

4. The physical presence necessary for the Commerce Clause's "substantial nexus" requirement must be more than a "slightest presence[.]" *Quill Corp. v. North Dakota*, 504 U.S. 298, 315 n. 8, 112 S. Ct. 1904, 1914 n. 8, 119 L. Ed. 2d 91, 108 n. 8 (*citing Nat'l Geographic Soc'y v. Cal. Bd. of Equalization*, 430 U.S. 551, 556, 97 S. Ct. 1386, 1390, 51 L. Ed. 2d 631, 636-37 (1977)). Instead, the in-state physical presence must be "'**significantly** associated with the taxpayer's ability to establish and maintain a market in'" the taxing state. *Tyler Pipe Indus. v. Wash. State Dep't of Revenue*, 483 U.S. 232, 250, 107 S. Ct. 2810, 2821, 97 L. Ed. 2d 199, 215-16 (1987) (emphasis by bold print added) (internal citation omitted).

5. Here, for the tax years in question, the taxpayer's only physical presence in West Virginia was by the extremely isolated and sporadic use of the in-state lawyer's(s') services and courts of this state in the *de minimis* number of credit card debt-collection actions. This extremely limited type and frequency of physical presence in state -- compared with the total volume of the taxpayer's business with West Virginia customers -- constitutes a "slightest presence" and is **not** "significantly" associated with the taxpayer's ability to establish and maintain a market in this state, for the time period involved in this matter.

6. A relevant procedural law is that, in a hearing before the West Virginia Office of Tax Appeals on a petition for refund, the burden of proof is upon a petitioner-taxpayer, to show that the petitioner-taxpayer is entitled to the refund. *See* W. Va. Code § 11-10A-10(e) [2002] and 121 C.S.R. 1, § 63.1 (Apr. 20, 2003).

7. The Petitioner-taxpayer in this matter has carried the burden of proof with respect to its contention that, as applied to the facts of this matter, W. Va. Code §§ 11-23-5a(d) [1996] (West Virginia business franchise tax) and 11-24-7b(d) [1996] (West Virginia corporate net income tax) violate the "substantial nexus" component of the United States Supreme Court's analysis of the United States Constitution's interstate "Commerce Clause," U.S. Const. art. I, § 8, cl. 3.

8. Accordingly, the Petitioner-taxpayer in this matter has carried the burden of proving its entitlement to the requested West Virginia state tax refunds, due to the lack of "substantial nexus" as contemplated by the Supreme Court of the United States.

DISPOSITION

WHEREFORE, it is the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that the Petitioner's petition for refund of business franchise tax, for

the year 1998, is hereby **AUTHORIZED**, plus any statutory interest.

It is **ALSO** the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that the Petitioner's petition for refund of West Virginia corporate net income tax, for the year 1998, is hereby **AUTHORIZED**, plus any statutory interest.

It is **ALSO** the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that the Petitioner's petition for refund of business franchise tax, for the year 1999, is hereby **AUTHORIZED**, plus any statutory interest.

It is **ALSO** the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that the Petitioner's petition for refund of West Virginia corporate net income tax, for the year 1999, is hereby **AUTHORIZED**, plus any statutory interest.

As set forth in W. Va. Code § 11-10A-18 [2002], the West Virginia State Tax Commissioner's Office is to see that the payment of these refunds, plus any statutory interest, is issued promptly.

APPENDIX D

West Virginia Code
Chapter 11. Taxation.
Article 23. Business Franchise Tax.

§ 11-23-1. Legislative finding.

This business franchise tax on corporations and partnerships is enacted pursuant to the provision of article X, section one of the constitution of this state, granting to the Legislature the authority to tax privileges, franchises and incomes of persons and corporations. The Legislature finds and declares that this franchise tax is imposed on the privilege of doing business in this state, and that this tax is not an ad valorem property tax imposed on the property of corporations and partnerships doing business in this state.

§ 11-23-3. Meaning of terms; specific terms defined.

. . .

(b) Terms defined.

. . .

(2) Capital.

The term "capital" of a taxpayer shall mean:

(A) Corporations.

In the case of a corporation, except an electing small business corporation, the average of the beginning and ending year balances of the sum of the following entries from Schedule L of Federal Form 1120, prepared following generally accepted accounting principles and as filed by the taxpayer with the Internal Revenue Service for the taxable year:

(i) The value of all common stock and preferred stock of the taxpayer;

(ii) The amount of paid-in or capital surplus;

(iii) The amount of retained earnings, appropriated and

unappropriated; and

(iv) Less the cost of treasury stock.

(B) S Corporations.

In the case of an electing small business corporation, the average of the beginning and ending year balances of the sum of the following entries from Schedule L of Federal Form 1120S, prepared following generally accepted accounting principles and as filed by the taxpayer with the Internal Revenue Service for the taxable year:

(i) The value of all common stock and preferred stock of the taxpayer;

(ii) The amount of paid-in or capital surplus;

(iii) Retained earnings, appropriated and unappropriated;

(iv) The amount of shareholders' undistributed taxable income;

(v) The amount of the accumulated adjustments account;

(vi) The amount of the other adjustments account; and

(vii) Less the cost of treasury stock.

(C) Partnerships.

In the case of a partnership, the average of the beginning and ending year balances of the value of partner's capital accounts from Schedule L of Federal Form 1065, prepared following accepted accounting principles and as filed by the taxpayer with the Internal Revenue Service for the taxable year.

(D) Additional items in capital.

The term "capital" for purposes of this article shall include such adjustments thereto as the tax commissioner deems necessary to properly reflect capital and such additional items from the accounts of the taxpayer as the tax commissioner may by regulation prescribe, which fairly represent the net equity of the taxpayer as defined in accordance with generally accepted accounting principles.

(E) Allowance for certain government obligations and obligations secured by residential property.

As to both corporations and partnerships, capital shall be multiplied by a fraction equal to one minus a fraction:

(i) The numerator of which is the average of the monthly beginning and ending account balances during the taxable year (account balances to be determined at cost in the same manner that such obligations, investments and loans are reported on Schedule L of the Federal Form 1120 or Federal Form 1065) of the following:

(I) Obligations and securities of the United States, or of any agency, authority, commission or instrumentality of the United States and any other corporation or entity created under the authority of the United States Congress for the purpose of implementing or furthering an objective of national policy;

(II) Obligations of this state and any political subdivision of this state;

(III) Investments or loans primarily secured by mortgages, or deeds of trust, on residential property located in this state and occupied by nontransients; and

(IV) Loans primarily secured by a lien or security agreement on residential property in the form of a mobile home, modular home or double-wide, located in this state and occupied by nontransients.

(ii) The denominator of which is the average of the monthly beginning and ending account balances of the total assets of the taxpayer as shown on Schedule L of Federal Form 1120, as filed by the taxpayer with the Internal Revenue Service or, in the case of partnerships, Schedule L of Federal Form 1065, as filed by the taxpayer with the Internal Revenue Service.

. . .

§ 11-23-4. Tax base determined.

The tax base of a taxpayer, for purposes of this article, shall be its capital, as defined and adjusted in section three [§11-23-3] of this article. If the taxpayer is also taxable in another state, then the tax base of the taxpayer shall be its capital, as defined in section three of this article, multiplied by its apportionment factor determined under section five [§11-23-5] of this article.

§ 11-23-5a. Special apportionment rules - Financial organizations.

(a) General.

The Legislature hereby finds that the general formula set forth in section five [§ 11-23-5] of this article for apportioning the tax base of corporations and partnerships taxable in this state as well as in another state is inappropriate for use by financial organizations due to the particular characteristics of those organizations and the manner in which their business is conducted. Accordingly, the general formula set forth in section five of this article may not be used to apportion the tax base of such financial organizations which shall use only the apportionment formula and methods set forth in this section.

. . .

(c) Out-of-state financial organizations with business activities in this state.

A financial organization that does not have its commercial domicile in this state and which regularly engages in business in this state shall apportion its tax base to this state by multiplying it by the special gross receipts factor calculated as provided in subsection (f) of this section. The product of this multiplication is the portion of its tax base that is attributable to business activity in this state.

(d) Engaging in business - nexus presumptions and exclusions.

A financial organization that has its commercial domicile in another state is presumed to be regularly engaging in business in this state if during any year it obtains or solicits business with twenty or more persons within this state, or if the sum of the value of its gross receipts attributable to sources in this state equals or exceeds one hundred thousand dollars. . . .

. . .

(f) Special gross receipts factor.

The gross receipts factor is a fraction, the numerator of which is the total gross receipts of the taxpayer from sources within this state during the taxable year and the denominator of which is the total gross receipts of the taxpayer wherever earned during the taxable year: Provided, That neither the numerator nor the denominator of the gross receipts factor shall include receipts from obligations described in paragraphs (A), (B), (C) and (D), subdivision (1), subsection (f), section six [§ 11-24-6], article twenty-four of this chapter.

. . .

West Virginia Code
Chapter 11. Taxation.
Article 24. Corporation Net Income Tax.
Part I. Definitions, Imposition of Tax and Rate, and Exemptions.

. . .

§ 11-24-3a. Specific terms defined.

For purposes of this article:

. . .

(25) West Virginia taxable income.

The term "West Virginia taxable income" means the taxable income of a corporation as defined by the laws of the United States for federal income tax purposes, adjusted, as provided in section six [§11-24-6] of this article: Provided, That in the case of a corporation having income from business activity which is taxable without this state, its "West Virginia taxable income" shall be such portion of its taxable income as so defined and adjusted as is allocated or apportioned to this state under the provisions of sections seven [§11-24-7] and seven-b [§11-24-7b] of this article.

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§ 11-24-7b. Special apportionment rules - Financial organizations.

. . .

(c) Out-of-state financial organizations with business activities in this state.

The West Virginia taxable income of a financial organization that does not have its commercial domicile in this state but which regularly engages in business in this state shall be the sum of: (1) The nonbusiness income component of its adjusted federal taxable income for the taxable year which is allocated to this state as provided in subsection (d), section seven of this article; plus (2) the business income

component of its adjusted federal taxable income for the taxable year which is apportioned to this state as provided in this section.

(d) Engaging in business - nexus presumptions and exclusions.

A financial organization that has its commercial domicile in another state is presumed to be regularly engaging in business in this state if during any year it obtains or solicits business with twenty or more persons within this state, or if the sum of the value of its gross receipts attributable to sources in this state equals or exceeds one hundred thousand dollars. . . .

. . .

(f) Apportionment rules.

A financial organization not having its commercial domicile in this state which regularly engages in business both within and without this state shall apportion the business income component of its federal taxable income, after adjustment as provided in section six [§ 11-24-6] of this article, by multiplying the amount thereof by the special gross receipts factor determined as provided in subsection (g) of this section.

(g) Special gross receipts factor.

The gross receipts factor is a fraction, the numerator of which is the total gross receipts of the taxpayer from sources within this state during the taxable year and the denominator of which is the total gross receipts of the taxpayer wherever earned during the taxable year: Provided, That neither the numerator nor the denominator of the gross receipts factor shall include receipts from obligations described in paragraphs (A), (B), (C) and (D), subdivision (1), subsection (f), section six [§ 11-24-6] of this article. . . .

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APPENDIX E

Ernst & Young
E Tax Alert
03/07/2007*

Quantitative Economics and Statistics; State and Local Taxation

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Analysis Finds That Businesses Are Subject to Over 3,300 State and Local Business Activity Taxes

An analysis by Ernst & Young's Quantitative Economics and Statistics Practice provides insight into the complexity and scope of state and local taxes imposed on business activities. The analysis provides a count of the number of business income, franchise or gross receipts taxes imposed by state and local jurisdictions on business entities.

Findings

Here are the key findings from the results presented in the table below:

- Business Income and Franchise Taxes
  - 47 states impose business income taxes
  - 31 states impose a franchise or business privilege tax based on net worth or other non-income tax bases
  - 728 local jurisdictions impose business income taxes
- Gross Receipts Taxes

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* [Available at http://www.ey.com/global/content.nsf/US/Tax_-_Quantitative_Economics_and_Statistics_-_Overview.]

- 17 states impose general gross receipts taxes on general businesses or utilities

- Approximately 1,185 local jurisdictions impose gross receipts taxes on general businesses, while 1,349 local jurisdictions impose gross receipts taxes on utilities

- In total, over 3,300 separate state and local business activity taxes are currently being collected by state and local governments.

- The number of business activity taxes that localities are authorized by the states to collect exceed 12,600.

The estimate of the number of business activity taxes imposed or authorized to be impose by jurisdictions are based on a number of diverse data sources, including U.S. Census of Governments collection data, state tax and regulatory agencies, local government associations, specific industry tax studies, and state and local tax law compilations. The count of authorized taxes is based primarily on tax codes in each state and U.S. Census counts of numbers of local jurisdictions by state.

State and Local Business Activity Taxes, Imposed or Authorized

State	State Business Income Tax Imposed*	Local Business Income Tax Imposed	Local Jurisdictions with Authority to Impose Business Income Tax	State Franchise or Business Privilege Tax Imposed	State General or Utility Gross Receipts Tax Imposed	Local General Gross Receipts Tax Imposed	Local Utility Gross Receipts Tax Imposed	Local Jurisdictions with Authority to Impose Gross Receipts Tax
Alabama	1	--	--	1	--	20	--	451
Alaska	1	--	--	--	--	--	1	1
Arizona	1	--	--	--	--	--	--	--
Arkansas	1	--	--	1	1	--	--	--
California	1	--	--	--	1	120	--	532
Colorado	1	--	--	--	--	--	--	--
Connecticut	1	--	--	--	1	--	--	--
Delaware	1	--	1	1	1	--	--	--
District of Columbia	1	--	--	1	1	--	--	--
Florida	1	--	--	--	1	--	--	--

State	State Business Income Tax Imposed*	Local Business Income Tax Imposed	Local Jurisdictions with Authority to Impose Business Income Tax	State Franchise or Business Privilege Tax Imposed	State General or Utility Gross Receipts Tax Imposed	Local General Gross Receipts Tax Imposed	Local Utility Gross Receipts Tax Imposed	Local Jurisdictions with Authority to Impose Gross Receipts Tax
Georgia	1	--	579	1	--	53	--	579
Hawaii	1	--	--	--	1	5	--	5
Idaho	1	--	--	--	--	--	--	--
Illinois	1	--	--	1	1	--	350	350
Indiana	1	--	--	--	1	--	--	--
Iowa	1	--	--	1	--	--	--	--
Kansas	1	--	--	1	--	--	--	--
Kentucky	1	139	543	1	--	12	--	224
Louisiana	1	--	--	1	--	--	6	362
Maine	1	--	--	1	--	--	--	--
Maryland	1	--	--	--	--	--	5	5
Massachusetts	1	--	--	--	--	--	--	--

State	State Business Income Tax Imposed*	Local Business Income Tax Imposed	Local Jurisdictions with Authority to Impose Business Income Tax	State Franchise or Business Privilege Tax Imposed	State General or Utility Gross Receipts Tax Imposed	Local General Gross Receipts Tax Imposed	Local Utility Gross Receipts Tax Imposed	Local Jurisdictions with Authority to Impose Gross Receipts Tax
Michigan	1	22	22	--	--	--	--	--
Minnesota	1	--	--	--	1	--	8	8
Mississippi	1	--	--	1	--	--	28	28
Missouri	1	3	792	1	--	--	--	--
Montana	1	--	--	--	--	--	--	--
Nebraska	1	--	--	1	--	--	--	--
Nevada	--	--	--	1	--	--	17	17
New Hampshire	1	--	--	1	--	--	--	--
New Jersey	1	--	--	1	--	--	--	--
New Mexico	1	--	--	1	1	--	135	135
New York	1	1	1	1	--	--	406	616
North Carolina	1	--	--	1	--	--	--	--

State	State Business Income Tax Imposed*	Local Business Income Tax Imposed	Local Jurisdictions with Authority to Impose Business Income Tax	State Franchise or Business Privilege Tax Imposed	State General or Utility Gross Receipts Tax Imposed	Local General Gross Receipts Tax Imposed	Local Utility Gross Receipts Tax Imposed	Local Jurisdictions with Authority to Impose Gross Receipts Tax
North Dakota	1	--	--	1	--	--	--	--
Ohio	1	558	1609	1	1	--	--	--
Oklahoma	1	--	590	1	--	--	--	--
Oregon	1	5	260	--	--	--	--	--
Pennsylvania	1	--	--	1	--	312	--	3288
Rhode Island	1	--	--	1	--	--	--	--
South Carolina	1	--	--	1	--	--	269	269
South Dakota	--	--	--	1	1	--	--	--
Tennessee	1	--	--	1	1	292	--	441
Texas	1	--	--	--	1	--	--	--
Utah	1	--	--	--	--	3	--	138
Vermont	1	--	--	--	--	--	--	--

State	State Business Income Tax Imposed*	Local Business Income Tax Imposed	Local Jurisdictions with Authority to Impose Business Income Tax	State Franchise or Business Privilege Tax Imposed	State General or Utility Gross Receipts Tax Imposed	Local General Gross Receipts Tax Imposed	Local Utility Gross Receipts Tax Imposed	Local Jurisdictions with Authority to Impose Gross Receipts Tax
Virginia	1	--	134	1	--	204	124	324
Washington	--	--	--	--	1	39	--	199
West Virginia	1	--	--	1	1	125	--	125
Wisconsin	1	--	--	--	--	--	--	--
Wyoming	--	--	--	1	--	--	--	--
Total	47	728	4,531	31	17	1,185	1,349	8,097

*Includes Michigan Single Business Tax and Texas Franchise Tax. Source: Ernst & Young. Tax provisions reflect current law as of 1/1/2007.

The estimates of the number of business activity taxes imposed or authorized to be imposed by local jurisdictions is a conservative estimate. For example, the estimates do not include the large number of business occupation and license taxes that are based on fixed fees or maximum dollar

amounts. Also excluded are severance taxes, insurance gross premiums taxes and other specialized taxes on specific industries.

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This Alert was prepared by the Quantitative Economics and Statistics Group and the State and Local Tax Group.